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Supreme Court, U.S.
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No. ______

IN THE

Supreme Court of the United States

U.S. RESTAURANT PROPERTIES, INC., ET AL.,

Petitioners

v.

CONVENIENCE USA, INC., GANT ACQUISITION LLC, ET AL.,

Respondents

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

In conjunction with the Bankruptcy Reform Act of 1978, Congress amended the Judicial Act to grant courts of appeals jurisdiction over appeals from bankruptcy judges. However, since the Bankruptcy Reform Act has became law, a judge-made bankruptcy rule known as "equitable mootness" has been creeping into federal appeals court jurisprudence. The equitable mootness rule is distinct from this Court's Article III-based justiciability doctrine of actual mootness. The court of appeals below declined to reach the merits of Petitioner's appeal based solely on its equitable mootness rule. The questions presented are:

1. Whether a court of appeals may refuse to exercise statutory jurisdiction over a perfected bankruptcy appeal on the basis of a judicially created rule of equitable mootness?

2. Whether, if the rule of equitable mootness is to be recognized by this Court as a valid exception to the statutory jurisdiction of the courts of appeal, the court below applied the correct equitable mootness rule?

3. Whether the equitable mootness rule, as applied in this case, violates Petitioner's rights to due process?

PARTIES TO THE PROCEEDING

Petitioners are U.S. Restaurant Properties, Inc., U.S. Restaurant Properties Operating, L.P., USRP (GANT 1), LLC, USRP (Gant 2), LLC, USRP (Gant 3), LLC, USRP (Gant 4), LLC, USRP (Gant 5), and USRP (Gant 6) (collectively "Petitioner"). No publicly held company owns 10% or more of Petitioner's stock. Respondents are Convenience USA, Inc., Gant Acquisition LLC, and LaSalle Bank National Association, Trustee (the "Bank").

TABLE OF CONTENTS

Page

OPINIONS BELOW 1
JURISDICTION 1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 1
STATEMENT 1
REASONS FOR GRANTING THE PETITION 4
CONCLUSION 30

TABLE OF AUTHORITIES

Cases:

Matter of 203 N. LaSalle St. P'ship, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999) 10, 11, 12, 23
In re 255 Park Plaza Associates Ltd. P'ship, 100 F.3d 1214 (6th Cir. 1996) 19
In re AOV Indus., Inc., 792 F.2d 1140 (D.C. Cir. 1986) 6, 20
In re Baker & Drake, Inc., 35 F.3d 1348 (9th Cir. 1994) 6, 20
Baltimore & Ohio O.R. Co. v. United States, 279 U.S. 781, 49 S.Ct. 492, 73 L.Ed. 54 (1929) 25
In re BCD Corp., 119 F.3d 852 (10th Cir. 1997) 20
In re Bel Air Associates, 706 F.2d 301 (10th Cir. 1983) 6, 19
In re Burger Boys, Inc., 94 F.3d 755 (2d Cir. 1996) 18

Cases—Continued: Page

In re Cafeteria Operators, L.P., 299 B.R. 384 (Bkrtcy. N.D. Tex, 2003).. 29
Capital Factors, Inc. v. Kmart Corp., 291 B.R. 818, aff'd 2004 WL 343520 (Feb. 24, 2004).. 21
Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939) 9, 10, 15, 23, 29
Central States v. Central Transport, Inc., 841 F.2d 92 (4th Cir. 1988)...................................... 6
Church of Scientology v. United States, 506 U.S. 9, 113 S.Ct. 447, 121 L.Ed.2d 313 (1992) 5
Colorado River Water Conservation District v. United States, 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).............................. 4, 15
In re Continental Airlines, 91 F.3d 553, cert. denied, 519 U.S. 1057, 117 S.Ct. 686, 136 L.Ed.2d 610 (1997)............................ 5, 6, 7, 17
In re Convenience USA, Inc., 2002 WL 230772 (Bankr. M.D.N.C. Feb. 12, 2002)................ 1
In re Convenience USA, Inc., 290 B.R. 558 22
In re Crystal Oil Co., 854 F.2d 79.................................. 6
Evitts v. Lucey, 469 U.S. 387, 105 S.Ct. 830, 83 L.Ed.2d 821 (5th Cir. 1988) 28
Great West Life and Annuity Insurance Co. v. Knudson, 534 U.S. 204, 122 S.Ct. 708, 151 L.Ed.2d 635 (2002)... 13
Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319 (1999).... 12, 13, 15
In re GWI PCS 1 Inc., 230 F.3d 788, *cert. denied,* 533 U.S. 964, 121 S.Ct. 2623, 150 L.Ed.2d 776 (5th Cir. 2000) 30

Cases—Continued: Page

In re Hamady Brothers Food Markets, 110 B.R. 815 (E.D. Mich. 1990) 6

Hunt v. Bankers Trust Co., 799 F.2d 1060 (5th Cir. 1986) 21

In re Information Dialogues, Inc., 662 F.2d 475, 478 (8th Cir. 1981) 6, 19

In re Joshua Slocum Ltd., 922 F.2d 1081 (3rd Cir. 1990) 17

In re Kmart Corp., No. 03-1956, 2004 WL 343520, at *2 (7th Cir. Feb. 24, 2004) 16

Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit, 507 U.S. 163, 113 S.Ct. 1160, 122 L.Ed.2d 517 (1993) 7

MAC Panel v. Virginia Panel Corp., 283 F.3d 622 (4th Cir. 2002) 3, 15

Magniac v. Thomson, 56 U.S. 281, 15 How. 281, 14 L.Ed. 696 (1853) 13

In re Manges, 29 F.3d 1034, cert. denied, 513 U.S. 1152 (1995) 7, 15, 21, 30

Miami Ctr. P'ship v. Bank of New York, 838 F.2d 1547 (11th Cir. 1988) 6

Mills v. Green, 159 U.S. 651, 16 S.Ct. 132, 40 L.Ed. 293 (1895) 8

Mohamed v. Kerr, 91 F.3d 1124 (8th Cir. 1996) 25

Norfolk Shipbuilding & Drydock Corp. v. Garris, Administratrix, 532 U.S. 811,121 S.Ct. 1927, 150 L.Ed.2d 34 (2001) 12

Northern Pacific Railway Co. v. Boyd, 228 U.S. 482, 33 S.Ct. 554, 57 L.Ed. 931 (1913) 8, 9, 10, 15, 23

Cases—Continued: Page

Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) 13
Official Committee of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.), 988 F.2d 322 (2d Cir. 1993) 5
In re Public Serv. Co., 963 F.2d 469 (1st Cir. 1992) 6, 30
In re PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000) 17
In re Roberts Farms, Inc., 652 F.2d 793 (9th Cir. 1981) 6, 10, 20
Ruiz v. Estelle, 666 F.2d 854, *cert. denied*, 460 U.S. 1042, 103 S.Ct. 1438, 75 L.Ed.2d 795 (1983) 21
In re Stone & Webster, Inc., 286 B.R. 532 (Bankr. D. Del. 2002) 13
The Aetna Casualty & Surety Co. v. LTV Steel Co., Inc., 68 F.3d 409 (2nd Cir. 1995 19
United States v. Munsingwear, Inc., 340 U.S. 36, 71 S.Ct. 104, 95 L.Ed. 36 (1950) 28
United States v. Raddatz, 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980) 14
In re UNR Industrial, Inc., 20 F.3d 766 (7th Cir. 1994) 6, 16, 30
In re Zenith, 329 F.3d 338 (3d Cir. 2003) 17

Constitution, statutes, regulations and rules:

U.S. Const., Art. I 13, 14
U.S. Const., Art. III 5, 8, 13, 14, 15
11 U.S.C. § 363(m) 6, 7, 19
11 U.S.C. § 364(e) 6, 7
11 U.S.C. § 365 2

Constitution, et al.—Continued: Page

11 U.S.C. § 1101 23
11 U.S.C. § 1127(b) 23
28 U.S.C. § 158 .... 3, 4, 13, 14, 23
28 U.S.C. § 1254 1
Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA), Pub.L.No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of U.S.C. Titles 5, 11, and 28) 14

Miscellaneous:

ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS at 37 (Federal Judicial Center 2000), Judith A. McKenna & Elizabeth C. Wiggins 28
Restatement (Second) of Contracts § 203(a) 3

PETITION FOR A WRIT OF CERTIORARI

The Petitioner respectfully petitions for a writ of certiorari to review the order of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The order of the court of appeals (App. 1a-2a) is not reported. The underlying opinion issued by the district court (App. 3a-5a) is not reported. The memorandum opinion of the bankruptcy judge (App. 6a-21a) is reported as *In re Convenience USA, Inc.*, 2002 WL 230772 (Bankr. M.D.N.C. Feb. 12, 2002).

JURISDICTION

The order of the court of appeals was entered on January 14, 2004. This petition for a writ of certiorari has been filed within 90 days of such order. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent provisions of the United States Constitution, the Judicial Code (Title 28, USC) and Bankruptcy Code (Title 11, USC) are reprinted in an appendix to this petition. (App. 24a-26a).

STATEMENT

In 1999, Gant Acquisition, LLC (the "Debtor") and the Petitioner entered into a 20-year lease. Pursuant to a single lease instrument, the Petitioner leased 27 properties to the Debtor, in exchange for a base rent of approximately $130,000 per month. When the Debtor and its affiliate (Convenience USA, Inc.) filed their Chapter 11 bankruptcy cases, the Debtor was leasing all 27 properties from the Petitioner.

Several months into the bankruptcy case, the Debtor filed a motion to reject so-called "unexpired leases." In this pleading the Debtor sought to divide the lease into separate leases for each of the 27 properties, to reject 6 of the "leases" and to have a declaration of rights that it could assume, assign or reject each of the remaining 21 so-called leases. Over the objection of the Petitioner, the bankruptcy judge authorized the Debtor to reject the "unexpired leases" pertaining to six properties pursuant to an order dated February 12, 2002. The bankruptcy judge issued a memorandum opinion in support of his order. (App. 6a-21a). The Petitioner timely appealed this order (and a later order authorizing rejection of six more "leases") to the District Court.

The practical effect of the bankruptcy judge's order is that the Debtor has been allowed to unilaterally reduce its rent obligations under the lease from approximately $130,000 to $80,000 per month. Furthermore, the Debtor has been allowed to abandon 12 undesired properties. These facts present unambiguous events of default under the lease for which the remedy of eviction would be available, but for the bankruptcy judge's order. What has occurred is a judicially approved unilateral modification of the lease contrary to law.

Federal law, specifically Section 365 of the Bankruptcy Code, permits the assumption or rejection of an unexpired lease. However, federal law requires the lease to be assumed or rejected *in toto*. Recognizing that federal law did not authorize the lease to be divided in this manner, the bankruptcy judge purported to follow Texas contract law to achieve the result. It was undisputed that Texas state law governs the question of whether the lease constitutes a single unexpired lease or represents 27 separate unexpired lease agreements. However, the bankruptcy judge's error is manifest by his reasoning that the lease term which prohibited this result could be disregarded as being "outweighed" by others. (App. 16a). Under Texas law, courts assume that parties to an instrument intend every clause to have some effect, and thus courts are not at liberty to disregard clauses under a balancing test. *See also* Restatement (Second) of Contracts § 203(a) (1981).

On appeal to the district court pursuant to 28 U.S.C. § 158(a), the district judge affirmed on the merits. (App. 3a). Petitioner timely appealed to the court of appeals pursuant to 28 U.S.C. § 158(d). Petitioner timely filed its Brief on the merits with the court of appeals. (App. 27a-73a). The Debtor and the Bank filed an Appellee Brief on the merits. Petitioner timely filed a Reply Brief. The Petitioner's appeal has been ripe for decision on the merits by the court of appeals since August 22, 2003, the date on which all briefing on the merits was complete.

At this point, the pleadings that frame this petition for certiorari come into focus. Unwilling to allow a review on the merits by the court of appeals, the Debtor and its Bank filed a Motion to Dismiss the Appeal on September 2, 2003. (App. 74a-100a). The Motion to Dismiss the appeal does not assert that the appeal should be dismissed for lack of jurisdiction or for a want of prosecution. Rather, the Motion to Dismiss is entirely premised on an "equitable mootness" rule. Specifically, the Debtor cited a rule announced by the Fourth Circuit in *MAC Panel v. Virginia Panel Corp.*, 283 F.3d 622 (4th Cir. 2002), which consists of four non-exclusive factors:

1. Whether the appellant sought and obtained a stay;
2. Whether the reorganization plan or equitable relief ordered has been substantially consummated;
3. The extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and
4. The extent to which the relief requested on appeal would affect the interests of third parties.

The Debtor asserted that during the 17 months since the bankruptcy judge's ruling on the lease divisibility controversy, the Debtor had achieved both confirmation and "substantial consummation" of its Chapter 11 plan. The Debtor asserted the lease had been assigned under the plan to a new entity owned by the Debtor's chief executive officer. The Debtor further asserted that the Petitioner was unable to obtain a stay pending appeal, that reversal would adversely impact "third parties," and that reversal on appeal would affect the "success of the plan."

The Petitioner filed a response in opposition. (App. 125a-155a). While it is undisputed that the Debtor's plan was confirmed, the Petitioner countered that "effective relief" could be given by the appeals court in view of the fact that over 15 years remained on the lease. In addition, the Petitioner countered that effective relief did not require the payments already made to other creditors under the plan be reversed, nor would reversal on appeal doom the Debtor's assignee to financial failure. The conflicting factual assertions of the Debtor and the Petitioner were presented to the court of appeals by affidavit.

On January 14, 2004, pursuant to a one sentence order, the court of appeals granted the Debtor's Motion and dismissed the appeal. (App. 1a-2a). Petitioner requests this Court grant certiorari to review this order of dismissal.

REASONS FOR GRANTING THE PETITION

The court of appeals has dismissed a perfected appeal in a way that conflicts with the applicable decisions of this Court. Further, the court of appeals has applied a rule of equitable mootness that conflicts with the rules applied in other Circuits.

First, the equitable mootness rule lacks a statutory basis. 28 U.S.C. Section 158(d) provides that courts of appeal "shall have jurisdiction" over bankruptcy appeals. The lower courts have a "virtually unflagging obligation" to exercise their statutory jurisdiction, *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 817, 96 S.Ct. 1236, 1246, 47 L.Ed.2d 483 (1976).

Further, under the prior holdings of this Court, an appeal is moot in a Constitutional sense only if events have taken place during the pendency of the appeal that make it "impossible for the court to grant 'any effective relief whatsoever.'" *Church of Scientology v. United States*, 506 U.S. 9, 12, 113 S.Ct. 447, 449, 121 L.Ed.2d 313 (1992). Thus, when a court can fashion some form of relief, even if it only partially redresses the grievances of the prevailing party, the appeal is not moot. The lease in controversy has a 15-year remaining term. Under the orders below, the Debtor (and its assignees) has been allowed to occupy premises at a reduced monthly rent of approximately $80,000. If the Petitioner is correct in its contention that the lease requires payment of approximately $130,000 of monthly rent, the court of appeals can provide "effective relief" for the balance of the lease term. The court of appeals could have reversed and remanded with instructions that the Debtor (and its assignees) are required to pay the full rent required under the lease as a condition to their continued occupancy of the premises for the remaining 15 years. Thus this appeal is not moot under this Court's justiciability doctrine of actual mootness, which has its origin in the case-or-controversy requirement of Article III of the Constitution.

This Petition requests this Court consider the validity of an equitable mootness rule that is not based upon the Constitution, or a statute, nor a holding of this Court. This bankruptcy rule of equitable mootness has been stated to mean that "an appeal should be dismissed as moot when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable." *See Official Comm. of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.)*, 988 F.2d 322, 325 (2d Cir. 1993). The courts of appeal have acknowledged that their doctrine of "equitable mootness" bears no relation to the justiciability doctrine of actual mootness. *See In re Continental Airlines*, 91 F.3d 553, 558-559 (3d Cir. 1996) (*en banc*), *cert. denied*, 519 U.S. 1057, 117 S.Ct. 686, 136 L.Ed.2d 610 (1997).

As part of the Bankruptcy Reform Act of 1978, Congress specifically identified the sorts of bankruptcy court orders that, absent a stay pending appeal, will become unreviewable on appeal. *See* 11 U.S.C. § 363(m) (specifying that certain sales of property of the debtor's estate to a purchaser in good faith cannot be amended or reversed on appeal, unless the sale is stayed during the appeal's pendency); 11 U.S.C. § 364(e) (similar rule for good-faith extensions of credit). In substance, Congress codified a "bona fide" purchaser for value rule that was specifically designed to encourage bidding for assets of a bankrupt entity.

After Congress enacted the Bankruptcy Code in 1978, however, the Ninth Circuit took that principle further, insulating from appellate review an entire "plan of arrangement," and establishing "the principle of dismissal of an appeal for lack of equity." *See In re Roberts Farms, Inc.*, 652 F.2d 793, 798 (9th Cir. 1981).[1] *See also ibid.* (failure to seek stay pending appeal "creates a situation rendering it inequitable to reverse the orders appealed from").[2] In the ensuing 23 years, other courts of appeals too have invoked "equitable" factors to dismiss some bankruptcy appeals, although they have not agreed about the limits of the rule or the factors dictating its application.

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[1] Eventually other circuits followed the Ninth Circuit's lead to some degree, as shown by their citation of *Roberts Farms*. *See, e.g., Continental Airlines III*, 91 F.3d 553 (3d Cir. 1996); *In re Baker & Drake, Inc.*, 35 F.3d 1348 (9th Cir. 1994); *In re UNR Indus., Inc.*, 20 F.3d 766 (7th Cir. 1994); *In re Chateaugay Corp.*, 988 F.2d 322 (2d Cir. 1993); *In re Public Serv. Co.*, 963 F.2d 469 (1st Cir. 1992); *In re Crystal Oil Co.*, 854 F.2d 79 (5th Cir. 1988); *Central States v. Central Transp., Inc.*, 841 F.2d 92 (4th Cir. 1988); *Miami Ctr. P'ship v. Bank of New York*, 838 F.2d 1547 (11th Cir. 1988); *In re Bel Air Assocs.*, 706 F.2d 301 (10th Cir. 1983); *In re Info. Dialogues, Inc.*, 662 F.2d 478 (8th Cir. 1981); *In re Hamady Bros. Food Mkts.*, 110 B.R. 815, 817-18 (E.D. Mich. 1990); *In re AOV Indus., Inc.*, 43 B.R. 468 (D.D.C. 1984), *rev'd on other grounds*, 792 F.2d 1140 (D.C. Cir. 1986).

[2] Notably, the analysis of equity in *Roberts Farms* (and other early cases) turned on the appellant's failure to *seek* a stay. It was not until much later that the courts began to apply the rule to cases in which an appellant had unsuccessfully sought a stay. *In re UNR Indus.*, 20 F.3d

The rule of equitable mootness is a relatively recent judicial construct of questionable foundation. As will be shown below, this Court has never endorsed it. To the extent the Bankruptcy Code addresses the issue, it appears to preclude the doctrine, because it specifically identifies the two kinds of bankruptcy court orders that, absent a stay pending appeal, will become unreviewable. *See* 11 U.S.C. § 363(m) and 11 U.S.C. § 364(e). The Code does not, however, provide that an entire plan of reorganization is unreviewable based on the absence of a stay. Under the maxim of *expressio unius est exclusio alterius*, Congress's express inclusion of two bankruptcy-law exceptions to appellate review indicates an intent to preclude the recognition of others. *See, e.g., Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168, 113 S.Ct. 1160, 1163, 122 L.Ed.2d 517 (1993).

To date, the most substantial public debate over the validity of the equitable mootness rule is found in a Third Circuit *en banc* decision. In *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996), a meritorious bankruptcy appeal was dismissed as "equitably moot" by the Third Circuit, sitting *en banc*, by a vote of seven-to-six. At page 567, Circuit Judge Alito wrote in dissent:

> The majority's decision in this case creates a bad precedent for our circuit. The majority adopts the curious doctrine of "equitable mootness," which it interprets as permitting federal district courts and courts of appeals to refuse to entertain

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766, 769 (7th Cir. 1994) *cert. denied*, 513 U.S. 999, 115 S.Ct. 509, 130 L.Ed.2d 416 (1994); *see also In re Manges*, 29 F.3d 1034, 1040 (5th Cir. 1994), *cert. denied*, 513 U.S. 1152 (1995).

> the merits of live bankruptcy appeals over which they indisputably possess statutory jurisdiction and in which they can plainly provide relief. According to the majority, there is no clear rule for determining when a bankruptcy appeal is "equitably moot." Instead, this is said to be a discretionary determination to be made in the first instance by the district court based on a weighing of five factors that the majority has culled from the opinions of our "sister circuits." In my view, if the doctrine of "equitable mootness" has any validity, it is more limited than the majority holds.

Judge Alito was correct in questioning the validity and scope of this "curious" doctrine, as it is in conflict with the applicable decisions of this Court.

I. The Order below conflicts with the holdings of this Court in *Northern Pacific Ry. Co.*, *Los Angeles Lumber*, *Grupo Mexicano*, and *Marathon Pipeline.*

In *Mills v. Green*, 159 U.S. 651, 16 S.Ct. 132, 40 L.Ed. 293 (1895), this Court established the Article III mootness doctrine, holding that dismissal of a case without consideration of the merits is required when no "effectual relief whatever" can be fashioned. However, subsequent to *Mills*, this Court considered and rejected arguments very similar to the equitable mootness claims presented below.

Northern Pacific Ry. Co. v. Boyd, 228 U.S. 482, 33 S.Ct. 554, 57 L.Ed. 931 (1913), presented a claim against the reorganized Northern Pacific Railroad. Boyd, a judicial lien creditor of the bankrupt corporation, asserted his rights against the reorganized corporation ten years after the adoption of its plan. Under the equity receivership plan, the assets of the Northern Pacific "Railroad" were sold free and clear of all creditor claims to a new entity – the Northern Pacific "Railway." After the foreclosure sale, Boyd attempted to assert a lien against the Railway's assets – despite the foreclosure sale. This Court ruled that it was unfair for the shareholders of the old Railroad to receive equity interests in the new Railway, when creditors such as Boyd had not been paid.

Significant for present purposes is the fact that investors claimed that Boyd should have been estopped from attacking a reorganization that had occurred ten years prior. They proceeded to argue that, in addition to encouraging reorganizations, this Court should require prompt action by those who oppose the reorganizations. This "laches by estoppel" claim is similar to that advanced below by the Debtor, specifically that the Petitioner should not be heard on appeal because it was unable to obtain a stay pending appeal. Finding that the delay in pursuing litigation was "excusable if not absolutely unavoidable," this Court held that "Boyd's silence...did not mislead the stockholders, nor did his non-action induce them to become parties to the reorganization plan." *Northern Pacific*, 228 U.S. at 510.

Similarly, the Petitioner's inability to obtain a stay pending appeal below did not mislead the parties. The Petitioner did not induce the Debtor to consummate the plan. The chief executive officer of the Debtor and its assignee closed the transaction knowing full well there was a risk that the Petitioner might prevail on appeal. (App. 137a-138a).

This Court's *Northern Pacific* case counsels against dismissing the Petitioner's appeal as moot, as does its subsequent holding in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939). Here the Court addressed the conditions under which former stockholders might participate in a plan of reorganization. The former stockholders had participated under a so-called "new value" rule which allows shareholders of the bankrupt corporation to participate in the plan of reorganization prior to full satisfaction of creditors' claims. Justice Douglas, writing on behalf of the Court, refused to have appeals court review limited by a bargain struck between the reorganizers and the new value investors.

> The scope of the duties and powers of the Court would be delimited by the bargain which reorganizers had been able to make with security holders before they asked the intercession of the court in effectuating their plan. Minorities would have their fate decided not only by the Court in application of the law of the land . . . but by the forces utilized by reorganizers in prescribing the conditions precedent on which the benefits of the statute could be obtained. (emphasis added)

Los Angeles Lumber, 308 U.S. at 129. Bargains consummated among the reorganizers (here the Debtor, its assignee and the Bank) do not restrict judicial authority to adjudicate appeals. In substance, this Court's holding in *Los Angeles Lumber* is inconsistent with an ability of parties to evade appellate court review through implementation of Chapter 11 plan transactions. The Debtor's Motion to Dismiss describes *ad nauseam* various plan transactions as a factual basis to bar review by appeals courts. (App. 88a-90a, 101a-110a). However, appeals court jurisdiction is not a function of the volume of paper used to close the plan transactions.

This Court's holdings *Northern Pacific Ry. Co. v. Boyd* and *Case v. Los Angeles Lumber Prods. Co.* remain among this Court's most important jurisprudence on the absolute priority rule in bankruptcy, as confirmed by this Court's recent analysis of these historic cases in *Matter of 203 N. LaSalle St. P'ship*, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). Yet they also stand for the principle that the public interest in allowing appeals courts to review disputed reorganization plans trumps any supposed equities of the willing participants to the bankruptcy plan.[3]

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[3] The equitable mootness rule appears to have been invented 42 years after *Los Angeles Lumber* in the Ninth Circuit opinion of *In re Roberts Farms, Inc.*, 652 F.2d 793 (9th Cir. 1981). It is curious that neither *Roberts Farms, Inc.* nor the mootness cases that have followed discuss *Northern Pacific Railway Co. v. Boyd* and *Case v. Los Angeles Lumber Products Co.*

Matter of 203 N. LaSalle St. P'ship also points to another problem with the equitable mootness rule applied below. The Fourth Circuit's equitable mootness rule requires consideration of the extent to which the relief requested on appeal would affect the "success" of the reorganization plan. There is no definition of a "successful plan" in the Bankruptcy Code. Petitioner argued below that in order for the Debtor's plan to be found "successful," all that is required under the "four corners" of the plan is that the Debtor deliver the property, cash, promissory notes and related instruments to the classes of creditors as provided in the plan. This has been done, and reversal would not require an annulment of these distributions. Further, the plan had no internal definition of "success" by which its success or failure could be tested, other than perhaps by reference to the items that have been delivered as described above. To be sure, the Debtor asserts that reversal will impact the "success" of the Debtor's assignee. However, the financial success of the Debtor's assignee is not synonymous to the "plan's success." A financial default by the assignee is not an event of a default under the Debtor's plan. (App. 134a-143a). The court of appeals ignored these points, which suggests that the Fourth Circuit's "success" standard is measured only by reference to the "Lord Chancellor's foot."

In *Matter of 203 N. LaSalle St. P'ship*, this Court was critical of a similar fuzzy standard that had been proposed as the measure for compliance with the absolute priority rule. Writing for the Court, Justice Souter observed that if the old equity holders could circumvent the absolute priority rule pursuant to contribution of "substantial money" then a most impractical test would result:

> "Substantial" or "significant" or "considerable" or like characterizations of a monetary contribution would measure it by the Lord Chancellor's foot, and an absolute priority rule so variable would not be much of an absolute.

Matter of 203 N. LaSalle St. P'ship, 119 S.Ct. at 1420. The Fourth Circuit's "success" test is likewise not much of a standard. Under the "success of the plan" standard, we can expect the conscience of one judge to be troubled in one case, but not another, and little coherence in the development of the law. This is not a sound approach to commercial law, where consistency of outcome is a virtue.

Shortly after deciding *Matter of 203 N. LaSalle St. P'ship,* this Court announced another principle that directly calls into question the authority of the courts of appeal to invent a rule of equitable mootness. Prior to 1999, perhaps the equitable mootness rule could have been perceived as a valid exercise of the inherent equitable powers vested in the federal courts. However in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319 (1999), this Court held that the federal courts are limited to such equitable remedies as existed in the English Court of Chancery in 1789, the year that Congress enacted the First Judiciary Act. Needless to say, the rule of equitable mootness in the context of corporate reorganization plans, was not an equitable remedy exercised by the 18th Century Court of Chancery. In *Grupo Mexicano* this Court again made reference to the "Chancellor's foot" problem, which is very apropos to the remarkably subjective "success of the plan" standard for equitable mootness. The "success of the plan" standard adopted by the court of appeals below provides no financial or accounting standard to measure success. Further, if a "successful plan" is premised on an erroneous legal ruling to achieve confirmation of the plan, opportunities for unchecked mischief in the bankruptcy courts abound.

Subsequent to *Grupo Mexicano*, this Court has signaled that the 1789 equity cutoff principle applies to bankruptcy law. *See Norfolk Shipbuilding & Drydock Corp. v. Garris, Administratrix*, 532 U.S. 811, 820,121 S.Ct. 1927, 1933, 150 L.Ed.2d 34 (2001), in which the Court observes with respect to its prior holding in *Grupo Mexicano* that the "equitable lawmaking power of bankruptcy courts [is] limited by statute.").[4] *See also Great West Life and Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 122 S.Ct. 708, 151 L.Ed.2d 635 (2002) (in evaluating whether equitable relief is available, "Rarely will there be need for any more antiquarian inquiry... than consulting, as we have done, standard current works such as Dobbs, Palmer, Corbin, and the Restatements, which make the answer clear"). These standard works on equity provide no historical authority for the "equitable mootness" rule. Rather, these works of equity jurisprudence recognize the maxim that entitlements to equitable relief are subordinate to statutory rights, or as this Court has said when the rights of parties are established by law, *equitos sequitus legem. Magniac v. Thomson*, 56 U.S. 281, 15 How. 281, 14 L.Ed. 696 (1853). The equitable mootness rule turns this maxim of equity on its head. Equitable mootness now trumps the statutory rights of appeal codified in § 158(d) of the Judicial Act. (App. 24a).

Finally, the equitable mootness rule runs afoul of the "separation of powers" principles embodied in the U. S. Constitution, and it has the potential of making the bankruptcy court a court of "first and last resort." As the Court held in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), constitutional problems are presented when Article I bankruptcy judges exercise the judicial power of the United States without adequate review by the Article III judiciary.

Fundamentally, the Petitioner requested *de novo* review by a three-judge panel of an Article III court of appeals, of an Article I judge's application of Texas contract law. This is the "bread and butter" stuff of appeals court review. As a result of the court of appeals dismissal, the bankruptcy judge's construction of the lease has not been "checked" by an Article III court of appeals. Congress intended that errors made by bankruptcy judges would be corrected by Article III circuit courts by providing that the court of appeals "shall have jurisdiction." 28 U.S.C. § 158(d).

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[4] Remarkably some lower courts have expressed the view that bankruptcy law is exempt from the principle announced in *Grupo Mexicano*, see e.g. *In re Stone & Webster, Inc.*, 286 B.R. 532, 537-538 (Bankr. D. Del. 2002).

Thus, any judge-made "equitable mootness" limitation on appeals jurisdiction must take into account that by eliminating full Article III judicial review, citizens may encounter unchecked error by bankruptcy judges. This problem is of constitutional magnitude, as our current bankruptcy jurisdictional system is premised upon the assumption that the Article III judiciary will review the orders of bankruptcy judges. In upholding a magistrate's (another "Article I" officer) power to rule on a pretrial motion, the Supreme Court has stressed the importance of review in maintaining sufficient Article III control over an adjunct. *United States v. Raddatz*, 447 U.S. 667, 681-82, 100 S.Ct. 2406, 2415-16, 65 L.Ed.2d 424 (1980). *Marathon* likewise emphasized the need for ample review of an "adjunct" by an Article III court. *Marathon,* 458 U.S. at 85, 102 S.Ct. at 2879 (Brennan, J., plurality opinion).

Under the "equitable mootness" rule, the review by Article III judges of the Article I bankruptcy adjuncts has been sharply curtailed. In circuits with Article I "bankruptcy appellate panels," Article III court review would be eliminated in most Chapter 11 cases. The court of appeals dismissal of the appeal under the mootness doctrine denied the Petitioner complete Article III court review of the bankruptcy judge's construction of a contract under Texas state law. The *Marathon* case arose in the context of an Article I bankruptcy judge deciding a state law issue. In the wake of *Marathon,* Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA), Pub.L.No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of U.S.C. Titles 5, 11, and 28), in order to increase Article III court supervision. If the current bankruptcy jurisdictional statute is to remain constitutional, the Article III courts of appeal should be directed to exercise their "unflagging obligation" over bankruptcy appeals. The bankruptcy mootness rule, which in effect makes the Article I bankruptcy judge a court of "first and last resort" is inconsistent with institutional and Constitutional concerns recognized in *Marathon*.

In sum, *Northern Pacific Ry. Co.*, *Los Angeles Lumber*, *Grupo Mexicano*, and *Marathon* (as well as *Colorado River Water*) all instruct that the court of appeals below should have reached the merits of the appeal. The court of appeals has so far departed from the authorities of this Court as to call for an exercise of this Court's supervisory power.

II. Even if this Court were to agree that the lower courts have authority to dismiss appeals under an equitable mootness rule, it should grant the Petition and establish uniform national rule.

The departure by the lower courts from the decisions of this Court has resulted in multiple strains of equitable mootness rules, and conflicts among the courts of appeals as to the scope and application of equitable mootness. The four-pronged test for equitable mootness adopted by the Fourth Circuit in *MAC Panel v. Virginia Panel Corp.*, 283 F.3d 622 (4th Cir. 2002), as applied by the court of appeals in its perfunctory order below, exemplifies a "docket-clearing" use of the rule. The *MAC Panel* standard, which in practice appears to require little scrutiny beyond whether a stay pending appeal has been obtained, has not been followed in other circuits.[5]

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[5] It appears the Fifth Circuit is the closest ally of the Fourth Circuit, as that court of appeals examines three factors: (i) whether a stay has been obtained, (ii) whether the plan has been "substantially consummated," and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan. *See In re Manges*, 29 F.3d 1034 (5th Cir. 1994), *cert. denied* 115 S.Ct. 1105 (1995).

In the Seventh Circuit, the court of appeals has banished the term "equitable mootness" from its jurisprudence. *See In re UNR Indus., Inc.*, 20 F.3d 766 (7th Cir. 1994). Recently in *In re Kmart Corp.*, No. 03-1956, et al., 2004 WL 343520, at *2 (7th Cir. Feb. 24, 2004), the Seventh Circuit explained that a type of "detrimental reliance" comparable to "the extension of new credit against a promise of security, or the purchase of assets in a foreclosure sale" is required to moot a bankruptcy appeal. The Seventh Circuit's "detrimental reliance" factor in its "prudential mootness" rule highlights a conflict between the Seventh and Fourth Circuits' rules. Generally to show detrimental reliance, a party must prove (1) that an appellant made a representation, (2) that the appellee justifiably relied on that representation, and (3) that the appellee changed its position to its detriment because of that reliance.

However, in this case, the Petitioner has constantly taken the position that there is only a single lease (not 27 leases), and Petitioner would appeal the lower court's holding to the contrary. The Debtor's own disclosure statement states:

> The orders of the Bankruptcy Court allowing rejection of the other 12 stores originally leased from USRP are on appeal to the United States District court for the Middle District of North Carolina. As in all litigation, there is some risk that the appellate court will not affirm the orders of the Bankruptcy Court. If that occurred, then the Plan may need to be modified based on the final rulings of the appellate court and any subsequent proceedings in the Bankruptcy Court. (App. 138a).

The chief executive officer of the Debtors and its assignee signed this disclosure statement. They had actual knowledge of the appeal, and knew of the risk of reversal. The lease was merely assigned (not purchased) under the plan. The Debtor's assignee cannot show a legally distinct type of reliance on the orders below than that of the hundreds of Kmart vendors who agreed to furnish and in fact did furnish post-bankruptcy credit based upon the bankruptcy judge's order that was reversed on appeal in *Kmart*. The Seventh Circuit recognized in *Kmart* that its holding will permit hundreds of payments authorized by the bankruptcy court to be undone; however, such reliance interests were insufficient to deny appeals court review.

The Fourth Circuit's equitable mootness rule is also in conflict with Third Circuit jurisprudence. While the Third Circuit narrowly adopted the following equitable mootness test: (1) whether the reorganization plan has been substantially consummated, (2) whether a stay has been obtained, (3) whether the relief requested would affect the rights of parties not before the court, (4) whether the relief requested would affect the success of the plan, and (5) the public policy of affording finality to bankruptcy judgments, *In re Continental Airlines*, 91 F.3d 553, 560 (3d Cir. 1996), it later seems to have retreated in practice, noting that "equitable mootness is limited in scope and should be cautiously applied." *See In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000). More recently in *In re Zenith*, 329 F.3d 338, 347 (3d Cir. 2003), the Third Circuit declared that dismissal under the equitable mootness rule should be the "rare situation."

Notably, the Third Circuit declined to apply its bankruptcy mootness rule to a landlord in the same posture as the Petitioner. In *In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1086 (3rd Cir. 1990), the bankruptcy court had held unenforceable a certain paragraph of the lease ("paragraph 20"), which provided that "in the event that Tenant's gross sales . . . do not average Seven Hundred Eleven Thousand Two Hundred Forty Five and 00/100 Dollars ($711,245.00) per lease-year either Landlord or Tenant may elect to terminate this Lease." The bankruptcy judge then approved the assignment of the lease (without paragraph 20) to an assignee, European Collections.

The landlord appealed, but failed to obtain a stay pending appeal. Nevertheless, the Third Circuit declined to dismiss the appeal on mootness grounds. The Third Circuit noted the material distinction between a challenge to the assignment of the lease, and the determination of the assignee's obligations under the lease. A landlord's challenge to the former might be mooted absent a stay pending appeal, however the landlord's challenge to the latter is not moot. The Third Circuit observed at page 1085:

> "Denney has not challenged the assignment of the lease to European Collections. Accordingly, the issue before us is not the assignment of the lease, as the Trustee asserts, but rather whether the bankruptcy court had the authority to excise paragraph 20 of that lease. The request to dismiss as moot must be denied, because we find that under the facts of this case Denney was under no obligation to obtain a stay."

Unlike the Fourth Circuit, the Third Circuit is willing to reach the merits of whether bankruptcy judges have discretion to remake leases, recognizing there is a principled difference between seeking relief from an appeals court's concerning obligations under the lease, and an appeals court's reversal of the assignment of a lease. Consistent with the Third Circuit, in *In re Burger Boys, Inc.*, 94 F.3d 755 (2d Cir. 1996), the Second Circuit held that a landlord's appeal of an order allowing assumption of a lease did not render moot the landlord's appeal, as the court could fashion effective relief by deeming the lease rejected. These Third Circuit and Second Circuit authorities conflict with the order below of the Fourth Circuit.

While in the Second Circuit a presumption of mootness will attach if "substantial consummation" of a plan is demonstrated, this presumption will give way if (1) the court can still provide effective relief; (2) granting relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (3) granting relief will not unravel the transactions that formed the basis of the plan of reorganization; (4) the parties that might be adversely affected by a grant of relief have received notice and an opportunity to be heard; and (5) the entity seeking relief has diligently pursued a stay of execution of the plan throughout the proceedings. *See The Aetna Cas. & Surety Co. v. LTV Steel Co., Inc.*, 68 F.3d 409 (2nd Cir. 1995). Petitioner's appeal would not have been declared moot under the Second Circuit's test because: (1) the court of appeals can provide effective relief for the 15-year balance of the lease; (2) the Debtor's plan did not provide for the Debtor to emerge as a revitalized entity, rather its assets have been assigned; (3) the relief requested by the Petitioner does not require the entire plan to be unraveled; (4) the parties that might be adversely affected (the Debtor's assignee and Bank) have received notice and opportunity to participate in the appeal; and (5) the Petitioner diligently pursued a stay of the plan confirmation order from the bankruptcy and district courts below. (App. 126a-143a).

Further conflicts among the circuits arise due to the absence of the Fourth Circuit's "success of the plan" factor in the opinions of other circuits. In the Sixth Circuit, the court of appeals has only adopted the bankruptcy mootness rule embodied by 11 U.S.C. § 363(m) in regard to the finality of a sale of property in bankruptcy. *See In re 255 Park Plaza Assocs. Ltd. P'ship*, 100 F.3d 1214 (6th Cir. 1996). The Sixth Circuit has not expanded the rule beyond an asset sale. In the Eighth Circuit, the court of appeals applies a limited mootness rule where the appellant does not request a stay. *See In re Info. Dialogues, Inc.*, 662 F.2d 475 (8th Cir. 1981). In the Tenth Circuit, the court of appeals has declared an appeal of a bankruptcy sale to a good faith purchaser to be moot. *See In re Bel Air Assocs.*, 706 F.2d 301 (10th Cir. 1983). However, the Tenth Circuit recognizes an exception to that rule when some effective relief is available under the

Bankruptcy Code or applicable state law. *See In re BCD Corp.*, 119 F.3d 852, 857 (10th Cir. 1997). In the District of Columbia Circuit, the court of appeals has adopted a bankruptcy mootness rule but has rejected a bright line test based upon "substantial consummation." *See In re AOV Indus., Inc.*, 792 F.2d 1140 (D.C. Cir. 1986). Because of the absence of a "success of the plan" test in the Sixth, Eighth, Tenth and D.C. Circuits, they appear willing to reach the merits of bankruptcy appeals.

In the Ninth Circuit, the birthplace of the equitable mootness rule, the court of appeals has refined its rule to state that "ultimately the decision whether to unscramble the eggs turns on what is practical and equitable." *See In re Baker & Drake, Inc.*, 35 F.3d 1348 (9th Cir. 1994)(this case also refers to "substantial culmination," not "consummation" as a mootness factor).

In this murky jurisprudence of equitable mootness, parties and lower courts are required to compare and distinguish their mootness facts from countless other fact patterns presented in earlier opinions. The absence of a uniform equitable mootness rule among our circuits presents cause for this Court to grant certiorari to review the administration of bankruptcy appeals. The relative merits of the following factors should be considered by this Court if there is to be a uniform rule of equitable mootness:

Stay Pending Appeal. Notably, the Ninth Circuit's analysis in *Roberts Farms* (and other early cases) turned on the appellant's failure to *seek* a stay. It was not until much later that the courts began to apply the mootness rule to cases such as this in which the Petitioner had requested but failed to obtain a stay. The Fourth Circuit's mootness practice places substantial weight on the inability of a party to persuade the trial court to grant a stay pending appeal.

The courts that have adopted an absence-of-stay factor have done so to point to an "omission" or "failure" on the part of the appellant, such that the harsh remedy of dismissal can be rationalized under equitable principles. However, in contrast to a defendant in a money judgment suit, who has an unqualified right of posting a *supersedeas* bond to stay enforcement of a judgment, a stay pending appeal is discretionary. Generally, our courts require a showing of four elements for a stay pending appeal of a bankruptcy order: (1) whether the movant has made a showing of likelihood of success on the merits, (2) whether the movant has made a showing of irreparable injury if the stay is not granted, (3) whether the granting of the stay would substantially harm the other parties, and (4) whether the granting of the stay would serve the public interest.

The test for a stay pending appeal did not originate in bankruptcy law. For example, in the Fifth Circuit, the elements for a stay pending appeal were announced in the context of a prisoner's rights appeal. *See Ruiz v. Estelle*, 666 F.2d 854 (5th Cir. 1982), *cert. denied*, 460 U.S. 1042, 103 S.Ct. 1438, 75 L.Ed.2d 795 (1983). Later, the Fifth Circuit held these elements should apply with equal force to bankruptcy appeals. *See Hunt v. Bankers Trust Co.*, 799 F.2d 1060 (5th Cir. 1986). Finally, the Fifth Circuit engrafted its stay pending appeal jurisprudence into its bankruptcy mootness rule. S*ee In re Manges*, 29 F.3d 1034 (5th Cir. 1994), *cert. denied* 115 S.Ct. 1105 (1995)(holding that whether the appellant obtained a stay pending appeal is the initial factor to be considered).

Candidly, "stay pending appeal" elements rarely will be established by appellants. *See e.g., Capital Factors, Inc. v. Kmart Corp.*, 291 B.R. 818, 823 (N.D. Ill. 2003), *aff'd* 2004 WL 343520 (Feb. 24, 2004), in which the district judge observed "it would be inconsistent for the bankruptcy court to enter the orders on the theory that prompt payments were necessary to keep Kmart operational, and then turn around and stay those orders." *Kmart*, 291 B.R. at 823. Bankruptcy judges invariably will conclude that granting a stay pending appeal of a Chapter 11 plan will "substantially harm the other parties," i.e., the other creditors scheduled to receive payments under the order.

Appellants must also show the absence of a stay will result in "irreparable harm." However, this places an appellant in a "catch-22" situation. The appellant might argue that absent a stay pending appeal the case will become equitably moot, and that such mootness is the irreparable harm that justifies the stay pending appeal. Of course if the appellant makes such an assertion, but the request for stay is denied, the appellant has admitted mootness, and the appeal is subject to dismissal in the court of appeals. Alternatively, the appellant could argue that the dispute will not become equitably moot on appeal (in which event he cannot show irreparable harm for purposes of the stay pending appeal). The bankruptcy judge below observed that he was not able to predict what the appeals court would hold to be equitably moot, thus held the Petitioner could not show irreparable harm. *See In re Convenience, USA, Inc.*, 290 B.R. 558, 562 (Bankr. M.D.N.C. 2003). This circular reasoning permits bankruptcy judges to routinely deny stays pending appeal.

These considerations, along with the fact that a bankruptcy judge will not ordinarily find the party requesting a stay pending appeal has a "likelihood of success" (having just granted the relief), demonstrate that the granting of a stay pending appeal of a bankruptcy plan will be a rare event. Petitioner appreciates that stays pending appeal should be granted infrequently, but it does not follow that appeals court jurisdiction should be predicated on whether the appellant obtains such a rare stay. This rule is particularly troublesome from an institutional perspective, as the judge that makes the call whether to allow appeals court review (the bankruptcy judge) is generally the same judge whose order has been appealed. In sum, an appellant's inability to persuade the bankruptcy judge that a stay pending appeal should be granted is a far cry from the "unclean hands" conduct upon which traditional equity jurisprudence of laches and estoppel is based, and should be given little or no weight.

Substantial Consummation. A factor applied in the Third, Fourth, Fifth, Seventh and Eleventh Circuits is whether the plan has been "substantially consummated." This term of art is borrowed from the Bankruptcy Code § 1101. (App. 25a). However, the sole statutory function of "substantial consummation" within the Bankruptcy Code is to provide a deadline after which Chapter 11 debtors may no longer return to the bankruptcy court to amend their confirmed plans. *See* 11 U.S.C. § 1127(b). There is no statutory link between the definition of "substantial consummation" and the jurisdiction granted under the Judicial Act. *Compare* 11 U.S.C. § 1127(b) and 28 U.S.C. § 158(d). (App. 24a-25a).

Reliance upon the "substantial consummation" definition as a basis to withhold appeals court jurisdiction results in an anomaly between appeals court review of Chapter 11 and Chapter 13 plans. Under the mootness rule followed below, "substantially consummated" Chapter 11 plans are not subject to appeals court review. However, Chapter 13 plans of consumer debtors remain subject to review on appeal, even if the debtor has made payments under its plans for several years. This is because there is not a "substantial consummation" definition applicable to Chapter 13 plans. Earlier this term, the Court heard arguments in *Till v. SCS Credit* (02-1016), in which the Court has considered the interest rate applicable to the Chapter 13 debtor's plan. Under an equitable mootness rule premised upon "substantial consummation," this Court would have been powerless to review the merits if *Till* were in Chapter 11. There is no indication that Congress intended that courts of appeals should have jurisdiction to review confirmed Chapter 13 plans, but not Chapter 11 plans.[6]

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[6] It is noteworthy that the reorganization plans reviewed in *Northern Pacific, Los Angeles Lumber* and more recently in *Matter of 203 N.*

Success of the Plan. As argued above, this Fourth Circuit factor is fatally vague, and should not be included in a national bankruptcy mootness rule.

Assumption of Risk. A factor that should be included in any bankruptcy mootness rule is whether the plan proponents knowingly assumed the risk of reversal on appeal. The Debtor's disclosure statement disclosed the risk that the order allowing rejection of the "12 leases" was under appeal, and that a reversal on appeal might require a modification of the plan. (App. 138a).

Divisibility of the Plan. Another factor that merits inclusion is whether the plan is divisible, such that the illegal term may be purged without materially impairing other creditors rights under the plan. Our courts interpret plans using contract law principles. Most plans are divisible in the sense that if one clause in a plan is determined on appeal to be invalid, such declaration does not render the entire plan invalid. Indeed the plan confirmed below includes a customary "savings clause," which provides that reversal by a court of appeals does not operate to avoid the entire plan.

Bona fide purchaser or assignee? Another factor that should be considered is whether the recipient of the property is a true "bona fide purchaser" or a mere assignee. The lease in question was not "purchased" under the plan, it was assigned. The Debtor's assignee did not pay any cash to the Debtor for the assets acquired under the plan. It is elementary ancient law that an assignee never stands in any better position than his assignor.

Is Restitution Available if the Plan is Reversed? A final factor that merits inclusion is whether termination of the appeal would result in a "windfall" being retained by a party (or its assignee) opposing the appeal. If the appeal is affirmed

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LaSalle St. P'ship would have met the "substantially consummated" definition by the time they reached this Court; nevertheless, the Court reviewed these reorganization appeals on the merits.

on the merits (and statistics suggest 73% of bankruptcy appeals are affirmed), then the "equitable mootness" rule serves no purpose. On the other hand, if the appeal has merit, and yet is dismissed under "equitable mootness," some party has received a windfall. This Court has recognized that "the right to recover what one has lost by the enforcement of a judgment subsequently reversed is well established." *Baltimore & Ohio O.R. Co. v. United States*, 279 U.S. 781, 786, 49 S.Ct. 492, 493, 73 L.Ed. 954 (1929); *See also*, *Mohamed v. Kerr*, 91 F.3d 1124, 1126 (8th Cir. 1996) ("It is a long-standing legal principle that '[a] person...whose property has been taken thereunder, is entitled to restitution if the judgment is reversed or set aside.'") (quoting Restatement of Restitution § 74 (1937)). Yet the equitable mootness rule of the court of appeals below fails to inquire as to whether restitution can and should be had against persons with notice of the appeal. This Court's holding in *Baltimore & Ohio O.R. Co.* further confirms a historic practice that upon reversal, the lower court should refer the matter to a fact finder to sort out any factually complex details of restitution. Instead, courts of appeals now rely on slogans such as "scrambled eggs" to evade the painstaking inquiry as to who received a windfall and what restitution can be achieved. If this Court were to adopt some form of an equitable mootness rule, certainly a factor to be considered is whether full or partial restitution can be achieved upon reversal.

While Petitioner urges this Court to banish equitable mootness from our bankruptcy jurisprudence, if some version of the rule is valid, this Court should grant certiorari to establish a national rule, and announce the specific factual considerations that must be followed by the lower courts.

III. The Order below conflicts with this Court's due process values.

This Court should grant certiorari because the process followed by the court of appeals in granting equitable mootness relief violates this Court's due process values. The court of appeal's equitable mootness rule is based upon "factors." Application of a factors test should require that a "fact finder" (a trial judge) receive the evidence of such factors, and then apply the factors.

The equitable mootness claim below was premised on facts that occurred outside the record on appeal. Generally, the Debtor has averred that many months after the bankruptcy judge authorized the lease to be divided into 27 leases, the lease was assigned to an assignee under a Chapter 11 plan, and that reversal at this point would prejudice the "success of its plan." These factual assertions have been presented to the court of appeals pursuant to an affidavit of a Mr. Jan Friederich, who testifies among other things that:

> "4. Although USRP [Petitioner] appealed the Bankruptcy Court's Orders permitting the Debtors to reject the 12 Rejected Leases, USRP did not seek to stay the Bankruptcy Court's Orders permitting the implementation of the rejection. Thus, the Debtors, in reliance[7] upon the findings, conclusions and orders of the Bankruptcy Court set forth in the Memorandum Opinion, negotiated with numerous creditors and parties to arrange a consensual resolution of the Debtors' business affairs, which resolution was embodied in the Plan that included the assumption and assignment of the USRP 15 Assumed Leases stores. . .
>
> 28. Therefore, if EXPREZIT! Group could not have assumed the Master Lease for the 15 USRP Stores, the remaining 15 non-USRP North Carolina stores would have become impossible to operate, and EXPREZIT! Group would not have purchased the 15 non-USRP North Carolina stores. Without

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[7] While this affiant claims to have relied on the bankruptcy judge's orders, the affiant does not testify that Petitioner made a representation, or that the affiant justifiably relied on Petitioner's representation, which would be elements for a detrimental reliance theory of mootness.

> the 30 North Carolina stores, EXPREZIT! Group would not be able to attain a level of "critical mass" necessary to negotiate favorable terms with vendors or support overhead expenses on the remaining Core Stores in Georgia, Florida and Alabama." (App. 111a-124a, paragraphs 4, 28 and 29).

Under the summary process followed below, the Petitioner has not been allowed to cross-examine Mr. Friederich on such assertions. By countervailing affidavit, Petitioner quoted financial projections found in the Debtor's disclosure statement projecting annual "earnings" of up to $8.3 million. (App. 159a). Petitioner has been denied the opportunity to cross examine Mr. Friederich to show that the additional monthly rent that would accrue if Petitioner prevails on appeal would not force the assignee to cease operations. Petitioner has been denied the opportunity to show that restitution could be had by requiring some of assignee's future cash flows to be redirected from the Bank (which holds a subordinate leasehold mortgage) to the Petitioner.

As noted above, the remedy of restitution is available to a person whose property had been taken under a judgment subsequently reversed. The quasi-summary judgment process followed by the court of appeals below has stripped the Petitioner of rights of restitution without due process. If courts of appeal are authorized to terminate appeals under an equitable mootness rule, Fifth Amendment due process requires that the opponent of mootness be allowed to test the factual assertions made by the proponent of mootness.

The Federal Rules of Appellate Procedure do not elucidate how complex disputed factual assertions of "equitable mootness" are to be processed by appeals courts. If this were a summary judgment case, and if "success of the plan" were a valid element to be established by the proponent of equitable mootness, a trial court judge could not have concluded as a matter of law that reversal would result in the business failure of the Debtor's assignee. This Court has held that where a State has created appellate process, procedures used in deciding appeals must comport with demands of due process. *Evitts v. Lucey*, 469 U.S. 387, 393, 105 S.Ct. 830, 83 L.Ed.2d 821 (1985). The summary process followed below violates Petitioner's Fifth Amendment due process rights.

Finally, this Court's due process values also protect parties to unreviewable orders. Under the rule of *United States v. Munsingwear, Inc.*, 340 U.S. 36, 39, 71 S.Ct. 104, 106, 95 L.Ed. 36 (1950), the appeals court, instead of merely dismissing, should have also vacated the orders and opinions below and remanded with a direction to dismiss. Orders and opinions which are not susceptible to review under a mootness rule (equitable or otherwise), should have no further force and effect, and should have no precedential value. This Court should grant certiorari and hold the process followed below fails this Court's due process values.

IV. The Public Interest would be served by granting the Petition.

The public has an interest in having the court of appeals reach the merits of bankruptcy appeals generally, so that legal precedents can be established. A recent study published by the Federal Judicial Center states, "it is beyond dispute that the surest way to move toward stability and predictability in bankruptcy law is to obtain more authoritative decisions from the court of appeals," and concludes that "lack of precedent" appears to be the most serious problem in the movement for reform of the bankruptcy appeals system.[8]

The equitable mootness rule frustrates the development of a body of coherent bankruptcy law by our "generalist" courts of appeals. Instead, the public, parties and lower court judges are faced with the dismal prospect of having bankruptcy judges citing other bankruptcy judge opinions as precedent. Bankruptcy judges adjudicate a substantial part of the commercial law cases in the United States, and their decisions guide business and its lawyers in structuring transactions. However, it would be alarming if their decisions in Chapter 11 cases are not subject to review by our courts of appeal. Remarkably, the bankruptcy judge's opinion below that the Fourth Circuit has declined to review has been cited and followed by another bankruptcy judge. *See In re Cafeteria Operators, L.P.,* 299 B.R. 384 (Bkrtcy. N.D. Tex, 2003)(holding that a lease is divisible, and citing the authority of the *Convenience USA* memorandum opinion). Elimination of a mootness rule that limits court of appeals review of the merits of these commercial law disputes would be helpful to the public at large.

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[8] See Judith A. McKenna & Elizabeth C. Wiggins, ALTERNATIVE STRUCTURES FOR BANKRUPTCY APPEALS at 37 (Federal Judicial Center 2000), and is available on the Center's website, http://www.fjc.gov/public/pdf.nsf/lookup/BankrApp.pdf/$file/BankrApp.pdf.

A "policy of finality" has been given as a justification for equitable mootness. Yet this finality policy has been implemented by the Bankruptcy Code's express protection of good faith purchasers and lenders. Congress chose not to protect other parties from bankruptcy appeals. While the delays which result from bankruptcy appeals may be an annoyance, as this Court has explained: A debtor . . . who invokes the aid of the federal courts in reorganizations . . . assumes all of the consequences which flow from that jurisdiction." *Los Angeles Lumber*, 308 U.S. 125.

Prior to the invention of equitable mootness, the risk of appeal was simply part and parcel of bankruptcy litigation. As a result of the equitable mootness rule, dockets of the lower courts have become cluttered with requests for stays pending appeal, filed so the appellant cannot be accused of failing to request a stay. After the request for stay is routinely denied, the appellee routinely moves to dismiss the appeal as moot. At both the district and circuit court levels, judicial resources that could have been directed at the merits of appeals are instead directed to the review and application of our turbid equitable mootness caselaw. With the ever expanding universe of bankruptcy filings (both in number and in terms of assets and liabilities), equitable mootness litigation will grow exponentially unless brought into check by this Court.[9] With the 25th anniversary of the Bankruptcy Reform Act of 1978 at hand, this Petition presents the appropriate opportunity for the Court to determine whether the "equitable mootness" rule is a valid rule, and if so, under what terms and conditions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

/s/ James Maxwell Tucker
JAMES MAXWELL TUCKER
Counsel of Record

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[9] Parties large and small have previously requested that this Court review the equitable mootness rule, including: (1) the United States of America, *see In re GWI PCS 1 Inc.*, 230 F.3d 788 (5th Cir. 2000), *cert. denied*, 533 U.S. 964, 121 S.Ct. 2623, 150 L.Ed.2d 776 (2001), (2) employees, *see In re UNR Indus., Inc.*, 20 F.3d 766 (7th Cir. 1994), *cert. denied*, 513 U.S. 999, 115 S.Ct. 509, 130 L.Ed.2d 416 (1994), (3) the debtor, *see Manges v. Seattle-First National Bank (In re Manges)*, 29 F.3d 1034, 1038-39 (5th Cir. 1994), *cert. denied*, 513 U.S. 1152, 115 S.Ct. 1105, 130 L.Ed.2d 1071 (1995), and (4) shareholders of a utility company, *see Rochman v. Northeast Utilities Service Group (In re Public Serv. Co.)*, 963 F.2d 469, 471-72 (1st Cir.), *cert. denied*, 506 U.S. 908, 113 S.Ct. 304, 121 L.Ed.2d 226 (1992).

APPENDIX

TABLE OF CONTENTS

Page

Appendix A (order of dismissal, 01/14/04) 1a

Appendix B (district court opinion, 03/18/03) 3a

Appendix C (bankruptcy court opinion & order, 02/12/02) .. 6a

Appendix D (statutory citations) 24a

Appendix E (brief of appellants, 07/03/03) 27a

Appendix F (joint motion to dismiss, 09/02/03) 74a

Appendix G (affidavits w/o exhibits) 101a

Appendix H (response to motion to dismiss, 09/23/03) 125a

Appendix I (affidavit) 156a

APPENDIX A

[Filed 01/14/04]

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

No. 03-1489
CA-02-236-1
CA-03-6-1
BK-01-81478C-11D

In Re: CONVENIENCE USA, INCORPORATED,

Debtor,

U.S. RESTAURANT PROPERTIES, INCORPORATED; U.S. RESTAURANT PROPERTIES OPERATING, L.P.; USRP (GANT 1), LLC; USRP (GANT 2), LLC; USRP (GANT 3), LLC: USRP (GANT 4), LLP, USRP (GANT 5), LLC; USRP (GANT 6), LLC,

Plaintiffs-Appellants,

Versus

CONVENIENCE USA, INCORPORATED; GANT ACQUISITION, LLC; LASALLE BANK CORPORATION,

Defendants-Appellees.

O R D E R

Appellees have filed a motion to dismiss and Appellants have filed a response.

The Court grants the motion.

Entered at the direction of Judge Michael, with the concurrence of Judge Niemeyer and Judge Shedd.

FOR THE COURT

/s/ Patricia S. Connor

Clerk

APPENDIX B

[Filed 03/18/03]

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

In re Convenience USA, Inc., et al.,
Debtors.

U.S. Restaurant Properties, Inc., et al.,
Appellants,

v. 1:02CV236
1:03CV006

Convenience USA, Inc., et al.,
Appellees.

ORDER AFFIRMING THE BANKRUPTCY COURT AND DENYING STAY PENDING APPEAL (Doc. 8)

In this case two appeals and a motion to stay are pending. The two appeals involve identical issues: Was a lease to the debtor of twenty-seven convenience/gasoline sales stores severable under Texas law so that the debtor could reject some yet assume and assign the lease and operation of others? The third is a motion to stay the Bankruptcy Court's order of consummation pending appeal of the severability issue. This Court has had hearings on the merits of the severability or "divisibility" question and, also, on the motion to stay.

The first issue concerns whether the Energy Lease is severable into twenty-seven separate leases. Under § 365 of the Bankruptcy Code, a Chapter 11 debtor may assume or reject unexpired leases in order to maximize the debtor's assets. Generally, a debtor may only assume or reject executory contracts under § 365 in their entirety. However, there are circumstances in which a contract that consists of a single document is divisible into several agreements, and the debtor may assume or reject the divisible agreements under § 365 without assuming or rejecting the entire contract. Creditor USRP contends that the Energy Lease is a single contract that must be accepted or rejected in its entirety, while Convenience, U.S.A. contends that the Energy Lease is divisible into twenty-seven separable contracts, each of which may be accepted or rejected.

The Bankruptcy Court below applied Texas law, conducted a thorough analysis of the lease provisions, and determined that the Energy Lease was divisible. *In re Convenience USA, Inc.*, available at 2002 WL 230772 (Feb. 12, 2002 Bankr. M.D.N.C.). The Bankruptcy Court's interpretation of the language of the contract is subject to a *de novo* standard of review. Under Texas law, three factors are considered to determine whether a contract, embodied in a single document, is divisible: (1) the intent of the parties; (2) the subject matter of the agreement; (3) the conduct of the parties. *Johnson v. Walker*, 824 S.W. 2d 184 (Tex. App. 1991). Application of these factors, with particular emphasis on the intent of the parties, requires the conclusion that the Energy Lease is divisible into separate leases. *See Blackstock v. Gribble*, 312 S.W.2d 289, 292-93 (Tex. Civ. App. 1958) (explaining that under Texas law, the "Intention of the parties as determined by the language used in a contract is controlling in determining whether the contract is severable or is entire and indivisible"). By the language of the contract, the parties clearly intended that the Energy Lease could be severed. Numerous provisions throughout the contract evidence this intent. For example, the parties had agreed on a method for apportionment of rent for each separate store, the lease specifically provided that USRP had the right to sell or otherwise transfer any of the stores under the lease at any time, and the contract included provisions for how the rent would be reduced if any of a number of contingencies occurred such as condemnation of a store or destruction of a store by fire or other natural disaster. The decision of the Bankruptcy Court that the Energy Lease is severable, and that Convenience USA may reject twelve stores is AFFIRMED.

As to the motion to stay, following an evidentiary hearing, the Bankruptcy Court set out its findings of fact and conclusions of law in a well-reasoned opinion applying the balancing of hardships rationale from the Fourth Circuit's opinion in *Direx Israel, Ltd. v. Breakthrough Medical Corp.*, 952 F.2d 802 (4th Cir. 1992). After review, it is the determination of this Court that, for the reasons set out in the opinion of the Bankruptcy Court in its Memorandum Opinion filed March 6, 2003, the motion for stay pending appeal should be DENIED. The balance of hardships tips decidedly in favor of the Debtor, the secured creditors, and the Unsecured Creditor's Committee who have approved the plan of consummation. USRP's probability of success on the merits is not sufficiently high to offset that balancing nor the public's interest in maintaining an ongoing business of one hundred forty-three convenience stores - the markets they serve, the competition they provide, and the jobs they presently support.

This the _18th__ day of March, 2003.

/s/ N. Carlton Tilley..........
United States District Judge

APPENDIX C

[Filed 02/12/02]

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

IN RE:	)	
	)	
Convenience USA, Inc., et al.,	)	Case No. 01-81478
	)	through
	)	01-81489
	)	Administratively
Debtors.	)	Consolidated
	)	

MEMORANDUM OPINION

These cases came before the court on February 7, 2002, for hearing upon the Motion of Debtors to Reject Certain Unexpired Non-Residential Real Estate Property Leases ("the Motion"). John A. Northen and Richard M. Hutson, II appeared on behalf of the Debtors, Alan D. McInnes appeared on behalf of U.S. Restaurant Properties, Inc. and six related limited liability companies who are landlords under the lease referred to in the Motion (hereinafter referred to collectively as "USRP"), John H. Small appeared on behalf of LaSalle Bank National Association and Diane P. Furr appeared on behalf of the Committee of Unsecured Creditors. Having considered the Motion, the objection filed on behalf of USRP and the evidence offered by the parties, the findings of the court pursuant to Bankruptcy Rules 9014 and 7052 are hereinafter set forth.

MATTER BEFORE THE COURT

The Motion was filed pursuant to § 365 of the Bankruptcy Code under which a trustee or Chapter 11 debtor, subject to the court's approval, may assume or reject an unexpired lease of the debtor. Under the lease referred to in the Motion, Debtors leased from the six landlords named in the lease 27 convenience stores for an initial lease term of 20 years. The Debtors seek to reject the lease only as to six of the leased properties. USRP objects to the motion, arguing that the Debtors must assume or reject the lease as a whole. The issue presented is whether the Debtors may reject the lease as to only six of the leased properties or whether the Debtors must assume or reject the lease as a whole.

FACTS

Debtor Convenience USA, Inc. ("Convenience USA") is a consolidator of convenience stores in the southeastern region of the United States and currently operates over 200 such stores. The stores generally sell gasoline, lottery tickets, money orders, food items and other convenience merchandise. The stores are owned and operated through entities which are subsidiaries or affiliates of Convenience USA. These subsidiaries and affiliates are the other debtors in this case. The subsidiaries and affiliates of Convenience USA were formed in connection with acquisitions of existing chains of convenience stores from various third parties over a period of approximately two years, from March 5, 1998 through January of 2000.

In the process of acquiring chains of convenience stores from various third parties, Convenience USA became aware that Gant Oil Company ("Gant Oil") operated a chain of 28 convenience stores located in North Carolina and was interested in selling its business. Gant Oil owned some of the

28 locations, leased some store locations from unrelated third patties and leased the remaining properties from related third parties ("the Gant Entities").

In March of 1999 Convenience USA formed Gant Acquisition, LLC ("Gant Acquisition") for the purpose of acquiring various assets involved in the Gant Oil business and engaged in negotiations with the Gant Entities for the acquisition of the Gant Oil business. The Gant Entities were interested in minimizing the income taxes related to the sale of the Gant Oil business, including the real property owned or leased by them. In order to reduce the tax obligations of the Gant Entities, Convenience USA, Gant Acquisition and the Gant Entities agreed to a structure for the acquisition of the Gant Oil business assets by Gant Acquisition under which Gant Acquisition agreed to buy the inventory, certain equipment and certain other business assets from the Gant Entities for $2,164,000.00 plus the cost of the inventory. In addition, the Gant Entities agreed to transfer 27 parcels of real estate with improvement and equipment to U.S. Properties Operating L.P. ("USRP Operating") or its assigns for the purchase price of $13,075,000.00 and USRP Operating, in turn, was to lease the 27 properties to Gant Acquisition with an annual base rent that was the product of 11.375% multiplied by the sum of the purchase price of the 27 properties plus the expenses incurred by USRP in purchasing the 27 properties.[1] Asset purchase agreements were entered into in May of 1999 and the deal was closed in July of 1999, at which time Gant Acquisition acquired the inventory, equipment and other business assets from the Gant Entities, Gant Entities closed the sale of the 27 convenience stores to USRP Operating and, pursuant to a lease document known as the Energy Lease, the 27 convenience stores were leased to Gant Acquisition by six different lessors who were the assigns of USRP Operating.

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[1] The 28th store was to be leased by Gant Acquisition directly from the existing landlord.

When these cases were filed on May 21, 2001, the Debtors were still leasing the 27 stores and have continued to do so. However, the six stores identified in the Motion have continued to operate at a loss since these cases were filed. The Debtors' efforts to improve the profitability of the six stores have not been successful and the six stores in question do not generate sufficient income to cover the rent or other expenses related to the operation of the six stores. As a result, the Debtors are sustaining substantial losses at the six stores. The Debtors have concluded that these losses cannot be stemmed and Debtors therefore wish to reject the lease of the six stores and close the six stores in order to avoid further losses to the estate.

DISCUSSION

The general rule is that in order for a contract to be assumed or rejected under § 365 of the Bankruptcy Code, the contract must be assumed or rejected in its entirety. See Stewart Title v. Old Republic Nat. Title, 83 F.3d 735, 741 (5th Cir. 1996). However, where a contract, though contained in a single document, is divisible into several different agreements, some of the divisible agreements may be assumed or rejected under § 365 without assuming or rejecting the entire contract. See id.; In re Gardinier, Inc., 831 P.2d 974 (11th Cir. 1987); In re Holly's, Inc., 140 B.R. 643, 681 (Bankr. W.D. Mich. 1992); In re Cutter's, Inc., 104 B.R. 886, 889 (Bankr. M.D. Tenn. 1989).

The parties in the present case are in sharp disagreement regarding the status of the Energy Lease.

USRP contends that the Energy Lease is a single, indivisible agreement which must be assumed or rejected in its entirety. The Debtors argue that the Energy Lease is a divisible contract and that the lease of each of the 27 leased properties is an executory agreement, divisible from the Energy Lease as a whole, that may be rejected by the Debtors without rejecting the leases of the other properties described in the Energy Lease.

The conflicting contentions of the parties involve their rights under the Energy Lease. Determination of contract or property rights by the bankruptcy courts ordinarily is controlled by state law. See Butner v. United States, 440 U.S. 48, 54, 99 S. Ct. 914, 917-18, 59 L.Ed.2d 136 (1979). Usually, the law of the forum state is controlling. However, in the present case, paragraph 18.15 of the Energy Lease provides that the lease shall be governed by the laws of the State of Texas. In the Fourth Circuit, a bankruptcy court must apply the conflicts of law rules of the forum state in determining which state's law to apply in making determinations of property rights in the assets of a bankruptcy estate. See In re Merritt Dredging Co., Inc., 839 F.2d 203 (4th Cir. 1988). This rule requires resort to North Carolina conflicts of law rules to determine which body of state law is controlling in determining the issues regarding the interpretation of the Energy Lease.

The general rule in North Carolina is that a choice of law or form selection clause in a contract is enforceable unless it is shown that the clause was the product of fraud or unequal bargaining power or that enforcement of the clause would be unfair or unreasonable. See Bell Atlantic Tricon Leasing Corp. v. Johnnie's Garbage Serv., Inc., 113 N.C. App. 476, 439 S.E.2d 221 (1994). In the present case, involving a contract negotiated by experienced business people, no such showing has been made. The court therefore will apply Texas law in accordance with the choice of law provision in the Energy Lease.

Application of Texas Law

The concept of divisible contracts ins recognized under Texas law. See In re Payless Cashways, Inc., 230 B.R. 120, 135 (8th Cir. BAP 1999) (discussing Texas law), aff'd 203 F.3d 1081 (8th Cir. 1999). Under Texas law, there is no one test or criterion that is determinative as to whether a contract is entire or divisible. See Johnson v. Walker, 824 S.W.2d 184, 187 (Tex. App. -- Ft. Worth 1991); St. John v. Barker, 638 S.W.2d 239, 243 (Tex. App. 1982); Chapman v. Tyler Bank & Trust Co., 396 S.W.2d 143, 146 (Tex. Civ. App. -- Tyler 1965). The determination of whether a contract is divisible depends primarily upon the intent of the parties, the subject matter of the agreement and the conduct of the parties. See Walker, 824 S.W.2d at 187; St. John, 638 S.W.2d at 243; Chapman, 396 S.W.2d at 146-47. "The intention of the parties as determined by the language used in a contract is controlling in determining whether the contract is severable or is entire and indivisible." Blackstock v. Gribble, 312 S.W.2d 289, 292-293 (Tex. Civ. App. - Eastland 1958). A frequently used test under Texas law to determine the divisibility of a contract is whether the consideration for the agreement is apportionable, and it generally is held that a contract is divisible where the part to be performed by one party consists of several distinct and separate items and the price to be paid by the other party is apportioned to each item. See Walker, 824 S.W.2d at 187; Click v. Seale, 519 S.W.2d 913, 918 (Tex. Civ. App. - Austin 1975); Chapman, 396 S.W.2d at 146-147. Single assent to a whole transaction involving several parts indicates that a contract is entire. However, the mere fact that agreements are embraced in one instrument will not make the writing entire and indivisible. See Click, 519 S.W.2d at 918. "In the end, the intent of the parties, as demonstrated by the language used, is controlling." In re Payless Cashways, Inc., 230 B.R. at 135.

A. **Intent of the Parties**

In the present case, the Energy Lease, of course, is a single instrument in which there apparently was single assent by the multiple parties to the lease. However, as the foregoing authorities make clear, this circumstance, standing alone, does not end the inquiry and make the agreement entire and indivisible. See Click, 519 S.W.2d at 918. The other circumstances of the case must be considered and under Texas law, the factor that weighs most heavily in deciding whether the Energy Lease is an entire contract or is divisible, is the intent of the parties as reflected in the provisions of the Energy Lease.

From an examination of the lease provisions, the court is satisfied that the intent of the parties in this case was to have a contract in which the lease of the various leased properties would be divisible. Such intent is reflected in several provisions of the Energy Lease, particularly those provisions dealing with the transfer of leased properties during the term of the lease and the provisions dealing with allocation of the rent.

Paragraph 18.2 of the Energy Lease, dealing with the transfer of a leased property by the landlord, and paragraph 18.24, entitled "Separate Lease Agreements," strongly reflect an intent that the lease be divisible with respect to the various leased properties. Under these provisions, the landlord has the unfettered right to sell or otherwise transfer any number of the leased properties at any time during the lease term. In such event, the Energy Lease requires the tenant to enter into a new lease with the transferee or new owner of the property being sold or transferred, and the Energy Lease continues in effect as to the remaining leased properties, except that the rent payable under the Energy Lease is reduced by the amount of the rent allocated under the lease to the property being sold or transferred. The effect of these provisions is that the property that is transferred is severed from the Energy Lease and becomes subject to a new lease with a new landlord, while the Energy Lease remains in effect as to the other leased properties, which reflects that the Energy Lease is a divisible contract. In fact, the lease has to be divisible in order for the landlord to be able to sell leased properties and still have the lease continue into effect as to the remaining properties. While paragraph 18.25 of the Energy Lease gives the tenant an option to purchase any leased property proposed for sale, such an option is entirely consistent with the Energy Lease being divisible because if the tenant exercises the option, one of the leased properties is severed from the Energy Lease and transferred to the tenant without affecting the lease of the remaining leased properties.

Paragraph 1.8 of the lease is the "Rent Reduction Amount" provision and also is strongly indicative of an intent to have a divisible contract. This provision, together with Exhibit G of the lease, provides for the apportionment of the rent and the assignment of specific amounts of rent to each of the 27 leased properties. This provision provides the mechanism for determining the amount of the rent reduction that is to occur when there is a division of the Energy Lease as a result of the sale or destruction of one or more leased properties. The amount of the reduction is the product of (i) total Base Rent (described in Exhibit D) prior to any reduction multiplied by (ii) the ratio of (A) the purchase price allocated pursuant to Exhibit G to the Building with respect to which the Rent Reduction Amount is calculated, divided by

(B) the aggregate purchase price allocations for each of the buildings. USRP's argument that the lease does not provide for an apportionment of the base rent under the lease ignores the foregoing terms of the Energy Lease, as well as the conduct of the parties following the execution of the lease. In actuality, the inclusion in the Energy Lease of provisions permitting the landlords to sell leased properties during the lease term and providing for the termination of the lease as to destroyed properties necessitated that the parties adopt a mechanism for adjusting the rent. Such a mechanism is contained in paragraph 1.8 which specifically sets forth a formula for allocating the base rent among the 27 properties. Moreover, following the execution of the Energy Lease, the parties agreed upon a schedule (page 2 of Debtors' Exhibit No. B) which specifically and on a property-by-property basis detailed the amount of the annual and monthly rent allocated to each of the 27 properties. Under Texas law, a circumstance that weighs very heavily in finding that a contract is divisible is if the part of the contract to be performed by one party consists of several separate items and the price to be paid by the other party is apportioned to each item. See Walker, 824 S.W.2d at 187; Click, 591 S.W.2d at 918; Chapman, 396 S.W.2d at 146-47. This is precisely what occurred in the present case--the landlords agreed to lease to the Debtors 27 separate and distinct properties and the parties allocated the rent among the various properties on both an annual and monthly basis.

There are other provisions that reflect an intent to have a divisible contract. Under paragraph 14.0 of the lease, if one of the leased properties is condemned, the entire lease is not terminated. Instead, the lease provides for the lease of the condemned property to be severed from the Energy Lease and for the lease to continue in effect as to the other leased properties. A similar division occurs in the event of the destruction of a building on a leased property. Under paragraph 13.0 of the lease, if one of the stores is damaged beyond repair, the lease terminates as to that leased property. This occurs without affecting the lease of the other leased properties except that under paragraph 1.8 the rent payable under the Energy Lease is apportioned and reduced by the amount of rent that was being paid for the leased property that was destroyed.

In arguing that these provisions do not reflect an intent that the Energy Lease be divisible, USRP contends that in adopting such provisions the parties were merely recognizing possible contingencies and dealing with them. While this may be true, it does not follow that these provisions do not reflect an intent that the lease be divisible. With respect to each of the contingencies, the parties had two choices. The parties could have elected to provide in the lease that if one of the leased properties were sold, condemned or destroyed, the entire lease would terminate. Presumably, the parties would have made this election if the economic realities had dictated such a resolution upon the loss of one or more of the leased properties. The parties did not elect such a provision. Instead, the parties elected to have a contract under which the lease of some of the properties may be terminated without affecting the continuing lease of the remaining properties. Choosing such terms reflects an intent to have a divisible contract.

Another provision of the Energy Lease reflecting the intent of the parties that the Energy Lease be divisible is paragraph 18.23 dealing with "Landlord Obligation." This provision recites that each of the six separate landlords named in the lease "is leasing its respective premises, as identified on Exhibit A, to tenant on a several, and not joint and several basis." Under this provision, none of the six landlords named in the lease is responsible for a default on the part of any other landlord and, in the event of a default by one landlord, the intent and effect of the provision is that the leases of the defaulting landlord would be severed from the Energy Lease and the Energy Lease would continue in effect as to the leased properties owned by the other landlords.

In concluding that the parties intended that the Energy Lease be divisible, the court also has considered paragraph 17 of the Energy Lease, which deals with default. In the event of a default, paragraph 17.2(b) permits the landlord to terminate the tenant's right to possession "of one or more (including all)" of the leased properties. This provision also permits a division of the lease by permitting the landlord to terminate any number of the leased properties, while leaving the lease in effect as to the remaining properties. This provision was characterized during the evidence as a "cross default" clause. As such, it is argued that the provision is inconsistent with an intent that the contract be divisible. To the extent that the default provisions are inconsistent with an intent that the lease be divisible, such provisions are insufficient to outweigh the other provisions of the lease which weigh more heavily in favor of a finding of an intent that the lease be divisible. Accordingly, the court concludes that it was the intent of the parties that the Energy Lease be divisible.

B. **Subject Matter of the Agreement**

The second prong to be considered under Texas law in deciding whether a contract is divisible is the subject matter of the agreement. A finding that the subject matter of the contract is such that the contract can be divided into two or more separate agreements that can be performed independent of each other weighs in favor of a finding that the contract is divisible.

The type of agreement involved in the present case, of course, is a lease. The subject matter of a lease is the property that is dealt with in the lease. In the present case, that subject matter consists of 27 separate and distinct convenience stores located in 18 different cities and scattered over a wide area of North Carolina. The Energy Lease deals with the various properties in the same way, imposing the same lease terms upon each location, except for the amount of rent allocated to the various locations. There is nothing in the evidence or in the Energy Lease that suggests that the various stores cannot be operated separately and independently of each other in accordance with the provisions of the lease. It thus appears from the nature of the properties and the terms of the Energy Lease that the Energy Lease can be divided into separate and independent leases for one or more of the properties. The subject matter aspect of the test for determining whether a contract is divisible therefore weighs in favor of a finding that the Energy Lease is a divisible contract.

C. **Conduct of the Parties**

The third point of focus under Texas law in determining whether a contract is divisible is the conduct of the parties. USRP points out that following the execution of the Energy Lease, the Debtors paid the rent under the lease by means of a single payment that was wire transferred into a sweep account that USRP was required to maintain for its lender. USRP argues that this method of payment reflects that there was no allocation of the rent among the various leased properties. However, the evidence also showed that following the execution of the lease the parties followed through with the provisions of the Energy Lease calling for an allocation of the rent and generated a schedule that incorporated both components of the "base rent" (i.e., the

$13,075,000.00 cost of the properties and the amount of the expenses incurred by USRP in purchasing the properties) and which specifically set forth an allocation of the annual and monthly rent for each of the 27 properties. With such an allocation in place, making a single payment into the sweep account had little significance since such payments could be allocated at any time using an allocation that was in place for just such purpose. The court therefore concludes that the conduct of the parties also favors a finding that the Energy Lease is divisible.

In summary, having considered the intent of the parties, the subject matter of the Energy Lease and the conduct of the parties, the court finds and concludes that the Energy Lease is a divisible contract such that each of the 27 leased properties may be regarded as the subject of a separate executory contract that stands on its own and may be dealt with separate and apart from the other leased properties.

Application of Bankruptcy Law

While state law is controlling on the issue of whether the Energy Lease is divisible, the rejection or assumption of executory contracts or unexpired leases pursuant to § 365 of the Bankruptcy Code is governed solely by federal law. See Otto Preminger Films, Ltd. v Ointex Entm't, Inc., 950 F.2d 1492, 1495 (9th Cir. 1991); In re Wheeling-Pittsburgh Steel Corp., 54 B.R. 772, 779 (Bankr. W.D. Pa. 1985). Section 365 was intended to permit a DIP to pick and choose among the debtors executory contracts and unexpired leases and to assume those which are beneficial to the estate and to reject those that are not beneficial. It having been determined in the present case that the Energy Lease is divisible into separate leases, the issue of whether the Debtors may reject six of those unexpired leases at this time is a matter of federal law involving the application of § 365.

D. Effect of Default Provisions

As noted above, paragraph 17.2(b), in effect, is a cross-default clause, since it purports to permit the landlords to terminate all of the leases based upon a default with respect to only one of the leased properties. USRP argues that the default provisions have the effect of inextricably intertwining the leases in such a fashion that the Debtors cannot reject less than the entire Energy Lease. In the bankruptcy context, it is well established that cross-default provisions do not integrate executory contracts or unexpired leases that otherwise are separate or severable. See In re Plitt Amusement Co. of Washington, Inc., 233 B.R. 837, 847 (Bankr. C.D. Cal. 1999). Moreover, cross-default provisions are unenforceable in bankruptcy where they would restrict the debtor's ability to fully utilize the provisions of § 365 with respect to an executory contract or unexpired lease. See In re Sanshoe Worldwide Corp., 139 B.R. 585, 597 (S.D.N.Y. 1992); In re Braniff, Inc., 118 B.R. 819, 845 (Bankr. M.D. Fla. 1989). The permissible limitations on the ability of a DIP to assume and assign executory contracts or unexpired leases under § 365 are found in § 365(c). Any contractual restriction on assignment under § 365 other than those specified in § 365(c) is invalidated by § 365(f). Thus, where a debtor is a party to a number of unexpired leases, cross-default clauses that would serve to prevent the debtor from assuming some of the leases without assuming the others at the same time are unenforceable under § 365(f). See In re Sambo's Rests., Inc., 24 B.R. 755, 757-58 (Bankr. C.D. Cal. 1982).

In the present case, because the Energy Lease is divisible, the Debtor in effect is a party to 27 separate unexpired leases. If given effect, the cross-default provisions in this case would prevent the Debtors from utilizing the provisions of § 365 to reject some of those leases, while reserving the decision whether to reject or to assume and assign the remaining leases to a later time. If the cross-default provisions were permitted to operate in such a fashion they would have the effect of foreclosing the ability of the Debtors possibly to assume and assign the other 21 leases pursuant to § 365. Such a result is contrary to § 365(f) and is not permissible under bankruptcy law. It follows that the default provisions in the present case do not limit the ability of the Debtors to reject six of the leases at this time, while leaving to another day the decision whether to reject the remaining leases or whether to assume and assign them in accordance with the provisions of § 365.

E. **Standard Applicable to Motion to Reject**

The standard to be applied in this case in determining whether the Debtors' decision to reject should be approved is the business judgment standard or test. See Lubrizol Enters. Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043, 1047 (4th Cir. 1985). Where the debtor's decision to reject an executory contract represents an exercise of sound business judgment, the decision should be approved by the court. The Debtors have sustained continuing losses from the operation of the stores located on the properties referred to in the Motion despite efforts to improve operations at the stores. There is no market for the stores at the current rental rates for the properties and unless the stores are closed the Debtors will continue to sustain significant losses at each location. Under these circumstances, Debtors' decision to close the stores in order to avoid further losses to the estate represents an exercise of sound business judgment. Accordingly, the Motion should be granted and the rejection sought by Debtors should be approved. A separate order so providing will be entered contemporaneously with the filing of this memorandum opinion.

This 12th day of February, 2002.

/s/ William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

IN RE:	)	
	)	
Convenience USA, Inc., et al.,	)	Case No. 01-81478
	)	through 01-81489
	)	Administratively
Debtors.	)	Consolidated

ORDER

In accordance with the memorandum opinoin filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED as follows:

(1) The Motion of Debtors to Reject Certain Unexpired Non-Residential Real Estate Leases is granted and the rejection by Debtors of the unexpired leases of the properties listed on attached Exhibit A is approved;

(2) Such rejection shall be effective as of January 31, 2002, provided that the Debtors vacate the premises listed on Exhibit A by February 14, 2002; and

(3) The lessors listed on Exhibit A shall have 60 days from the date of this order within which to file any claims for damages based upon Debtors' rejection pursuant to this order.

This 12th day of February, 2002.

/s/ William L. Stocks
WILLIAM L. STOCKS
United States Bankruptcy Judge

EXHIBIT A

Store #	Address	Lessor
810	648 Waughtown Street Winston-Salem, NC	USRP (Gant 2), LLC
812	1078 Cedar Point Blvd. Swansboro, NC	USRP (Gant 2), LLC
815	4862 Arendell Street Morehead City, NC	USRP (Gant 3), LLC
818	150 Highway 70W Havelock, NC	USRP (Gant 3), LLC
830	1310 Live Oak Street Beaufort, NC	USRP (Gant 5), LLC
832	1915 West Webb Avenue Burlington, NC	USRP (Gant 5), LLC

APPENDIX D

1. Article 1, Section 8 of the United States Constitution states as follows:

The Congress shall have power . . . To establish . . . uniform laws on the subject of bankruptcies, throughout the United States . . .

2. Article III, Section 1 of the United States Constitution states as follows:

The judicial power of the United States shall be vested in one Supreme Court, and in such Inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the Supreme and Inferior Courts, shall hold their offices during good behaviour; and shall, at stated times, receive for their services a compensation, which shall not be diminished during their continuance in office.

3. The Fifth Amendment, United States Constitution states as follows:

. . . [N]or shall any person . . . be deprived of life, liberty, or property, without due process of law . . .

4. Section 158(a) and (b) of Title 28 of the United States Code states as follows:

(a) The district courts of the United States shall have jurisdiction to hear appeals,

(1) from final judgments, orders, and decrees;

(2) from interlocutory orders and decrees issued under section 1121(d) of title 11 increasing or reducing the time periods referred to in section 1121 of such title; and

(3) with leave of the court, from other interlocutory orders and decrees;

(b) of bankruptcy judges entered in cases and proceedings referred to the bankrutpcy judges under section 157 of this title.

5. Section 158(d) of Title 28 of the United States Code states as follows:

(d) The courts of appeals shall have jurisdiction of appeals from all final decisions, judgments, orders, an decrees entered under subsections (a) and (b) of this section.

6. Section 363(m) of Title 11 of the United States Code states as follows:

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

7. Section 364(e) of Title 11 of the United States Code states as follows:

(e) The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

8. Section 1101(2) of Title 11 of the United States Code states as follows:

(2) "substantial consummation" means –

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan.

9. Section 1127 of Title 11 of the United States Code states as follows:

(a) The proponent of a plan may modify such plan at any time before confirmation, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. After the proponent of a plan files a modification of such plan with the court, the plan as modified becomes the plan.

(b) The proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan, but may not modify such plan so that such plan as modified fails to meet the requirements of sections 1122 and 1123 of this title. Such plan as modified under this subsection becomes the plan only if circumstances warrant such modification and the court, after notice and a hearing, confirms such plan as modified, under section 1129 of this title.

APPENDIX E

[Filed 07/03/03]

RECORD NO. 03-1489

In the

United States Court Of Appeals

For The Fourth Circuit

U.S. RESTAURANT PROPERTIES, INC., ET AL.,

Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., ET AL.,

Defendants-Appellees.

On Appeal From The United States District Court
For The Middle District Of North Carolina (Durham)

BRIEF OF APPELLANTS

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TABLE OF CONTENTS

(omitted)

TABLE OF AUTHORITIES

(omitted)

JURISDICTION STATEMENT

This is a bankruptcy appeal. Pursuant to 28 U.S.C. § 158(d) this Circuit Court has jurisdiction to hear this appeal of a final order of the District Court issued under 28 U.S.C. § 158(a). The District Court's Order was issued on March 18, 2003, and Appellants timely filed a Notice of Appeal on April 17, 2003.

STATEMENT OF THE ISSUES

1. Whether the lower courts erred in construing Texas contract law with respect to the divisibility of the Energy Lease between the Landlord and the Debtor?

2. Whether the lower courts erred in applying Texas contract law with respect to the divisibility of the Energy Lease between the Landlord and the Debtor?

3. Whether the lower courts erred in authorizing the Debtors to reject less than all of the Energy Lease pursuant to Section 365 of the Bankruptcy Code?

STATEMENT OF THE CASE

Convenience USA, Inc., Gant Acquisition LLC (the "Debtor") and certain other affiliates commenced their voluntary chapter 11 cases (Nos. 01-81478 through 01-81489) in the United States Bankruptcy Court for the Middle District of North Carolina, Durham Division, on May 21, 2001. Approximately 22 months earlier, the Debtor had entered into a twenty-year lease with six of the affiliated Appellants, namely, USRP (GANT 1), LLC, USRP (Gant 2), LLC, USRP (Gant 3), LLC, USRP (Gant 4), LLC, USRP (Gant 5), and USRP (Gant 6) (collectively "Landlord" or "USRP") covering 27 store properties (the "Energy Lease"). [JA 26-63]. On December 26, 2001, the Debtor and affiliates (collectively the "Debtors") filed a Motion to Reject Certain Unexpired Non-Residential Real Estate Leases (the "Motion") which sought to divide the Energy Lease into separate leases for each of the 27 properties, to reject 6 of the leases, and to have a declaration of rights that it could assume, assign or reject each of the remaining 21 leases. [JA 9-22]. The Debtors filed a supplement to the Debtor's Motion to Reject Certain Unexpired Non-Residential Real Estate Leases on or about January 18, 2002. [JA 23-69].

On February 4, 2002, the Appellants filed their "Objection of USRP to Debtors' Motion to Reject Certain Unexpired Non-Residential Real Estate Leases." An evidentiary hearing on the Motion was held on Thursday, February 7, 2002, before the Honorable William L. Stocks, Bankruptcy Judge. [JA 70-208].[2] On February 12, 2002, the bankruptcy judge issued his Order authorizing the Debtor to reject the so-called "unexpired leases" pertaining to six properties. [JA 209-210]. On the same date, the bankruptcy judge issued a Memorandum Opinion in support of his Order. [JA 211-229]. Appellants timely filed a Notice of Appeal from such Order on February 20, 2002, which was assigned Docket No. 1:02-CV-236. [JA 1-4]. Subsequently, the Debtors under the same rationale "rejected" six more stores. See "Notice by Debtors of Rejection of Certain Unexpired Nonresidential Real Property Leases (Store Nos. 802, 808, 811, 822, 826 and 828)" filed October 21, 2002 in the Bankruptcy Court. [JA 241-242]. The Debtor's requested process for rejection of these additional six stores had been approved by that "Order Granting Motion to Extend Time to Assume or Reject Unexpired Leases on Nonresidential Real Property Through and Including January 31, 2003" filed October 21, 2002 in the Bankruptcy Court. [JA 230-240]. The Landlord has also appealed this Order, which was assigned docket # 1:03CV006. [JA 5-8]. The District Court consolidated these appeals, and by Order dated March 18, 2003 affirmed the decision of the bankruptcy judge. [JA 243-246]. Appellants timely filed a Notice of Appeal from such Order on April 17, 2003. [JA 247-249].

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[2] This reference is to the entire transcript of the February 7, 2002 hearing (the "Transcript").

STATEMENT OF FACTS

Appellants have no material disagreement with the bankruptcy judge's recitation of certain background facts, as set forth on pages 2 through 4 of the Memorandum Opinion. [JA 212-214]. In summary, as found by the bankruptcy judge, the undisputed background facts are as follows. Convenience USA, Inc. ("Convenience USA") is an owner and operator of convenience stores in the southeastern region of the United States. The stores generally sell gasoline, lottery tickets, money orders, food items and other convenience merchandise. The stores are owned and operated through entities which are subsidiaries or affiliates of Convenience USA. The subsidiaries and affiliates of Convenience USA were formed in connection with acquisitions of existing chains of convenience stores from various third parties over a period of approximately two years, from March 5, 1998 through January of 2000.

In the process of acquiring chains of convenience stores from various third parties, Convenience USA became aware that Gant Oil Company ("Gant Oil") operated a chain of convenience stores located in North Carolina and was interested in selling its business.

In March of 1999 Convenience USA formed Gant Acquisition, LLC ("Gant Acquisition") for the purpose of acquiring various assets involved in the Gant Oil business and engaged in negotiations with the Gant Entities for the acquisition of the Gant Oil business.

The Gant Entities agreed to transfer 27 parcels of real estate with improvement and equipment to U.S. Properties Operating L.P. ("USRP Operating") or its assigns for the purchase price of $13,075,000.00 and USRP Operating, in turn, was to lease the 27 properties to Gant Acquisition with an annual base rent that was the product of 11.375% multiplied by the sum of the purchase price of the 27 properties plus the expenses incurred by USRP in purchasing the 27 properties. An asset purchase agreement was entered into in May of 1999 and the deal was closed in July of 1999, at which time Gant Acquisition acquired the inventory, equipment and other business assets from the Gant Entities, Gant Entities closed the sale of the 27 convenience stores to USRP Operating and, pursuant to a lease document known as the Energy Lease,[3] the 27 convenience stores were leased to

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[3] During the February 7, 2003 evidentiary hearing on the Motion, the Energy Lease was admitted as Debtor's Exhibit A and also as Landlord's

Gant Acquisition by the six affiliated assignees of USRP Operating that are collectively the Landlord.

When Gant Acquisition, Convenience USA and other affiliates filed their bankruptcy cases on May 21, 2001, the Debtor was still leasing all 27 stores from the Landlord.

Certain other relevant facts in the record are discussed in the arguments below.

SUMMARY OF ARGUMENT

The Landlord will show that Texas law required the bankruptcy judge to construe the Energy Lease as an integrated, single lease agreement. Federal bankruptcy law permits the Debtor an option to assume or reject the entire Energy Lease as a whole. The bankruptcy judge erred by construing the Energy Lease as 27 separate lease agreements, each of which could be separately assumed or rejected. The bankruptcy judge also erred by treating the "abandonment-default" clause in the Energy Lease as mere surplusage, unenforceable under some supposed federal law principle.

Alternatively, even if the Energy Lease can be considered "divisible," that label begs the question of "divisible by who"? Under Texas law, parties are free to contract on divisibility issues. Here the parties agreed that only the Landlord had the option to divide, and the lower court erred in implying a right in favor of the Debtor to divide the Energy Lease into 27 leases.

Exhibit 1 without objection. [JA 88, 127]. A copy of the Energy Lease is found in the Joint Appendix under Tab 5.

ARGUMENT

Standard of Review

Factual determinations of a bankruptcy judge are reviewed under the clearly erroneous standard, however legal conclusions are reviewed *de novo*, see Bankruptcy Rule 8013, and *Safety-Kleen, Inc. (Pinewood) v. Wyche*, 274 F.3d 846 (4th Cir. 2001). The issues presented in this appeal should be reviewed *de novo* without deference to the legal conclusions of the district judge and bankruptcy judge as to the interpretation and construction of the Energy Lease. The district judge correctly held that his review of the bankruptcy judge's order was to conducted under the *de novo* standard of review. Unfortunately, as shown herein the district judge misconstrued Texas contract law principles. The District Court's order is reviewed by this Circuit Court under the *de novo* standard of review.

Discussion of the Issues

I. THE LOWER COURTS ERRED IN CONSTRUING TEXAS CONTRACT LAW WITH RESPECT TO THE DIVISIBILITY OF THE ENERGY LEASE BETWEEN THE LANDLORD AND THE DEBTOR.

II. THE LOWER COURTS ERRED IN APPLYING TEXAS CONTRACT LAW WITH RESPECT TO THE DIVISIBILITY OF THE ENERGY LEASE BETWEEN THE LANDLORD AND THE DEBTOR

III. THE LOWER COURTS ERRED IN AUTHORIZING THE DEBTORS TO REJECT LESS THAN ALL OF THE ENERGY LEASE

PURSUANT TO SECTION 365 OF THE BANKRUPTCY CODE.

Argument 1: The Energy Lease constitutes a single lease of 27 properties, not 27 separate leases.

Federal law, specifically Section 365 of the Bankruptcy Code, permits the assumption or rejection of an unexpired lease.[4] However, federal law does not provide an answer to the question of whether the Energy Lease is a single unexpired lease, or whether it represents 27 separate unexpired lease agreements. State law provides the substantive contract law principles to follow in the interpretation and enforcement of a lease.

The bankruptcy judge correctly navigated the choice of law issue, holding that Texas state law governs the interpretation of the Energy Lease. [JA 216]. However, the bankruptcy judge erred in his application of Texas contract law principles by improperly construing the Energy Lease to be 27 separate unexpired leases.

General Principles

Under general principles of contract law followed by Texas courts, the primary concern of the court is to ascertain and give effect to the intentions of the parties as expressed in their written instrument. *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. 1996), reh'g of cause overr. (Aug. 16, 1996). Under Texas law, the intention of the parties must be determined primarily from the body of the instrument itself.[5]

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[4] *See* 11 U.S.C. § 365(a).

[5] *Pacific Mut. Life Ins. Co. v. Westglen Park, Inc.*, 325 S.W.2d 113 (Tex. 1959), reh'g of cause overr. (Jul 8, 1959).

The term "construction," insofar as the Texas law of contracts is concerned, implies uncertainty as to the meaning of an agreement,[6] as the rules of construction enable a court to ascertain from language used in a contract the manner and extent to which parties intended to be bound. Consequently, if the provisions of a contract are clear and unambiguous, there is then nothing in the agreement that permits construction by a court. Under Texas law, a court is not at liberty to revise an agreement while professing to construe it,[7] particularly a formal contract which bears evidence that the parties have carefully chosen language to express their intentions.[8]

The crux of this appeal is whether the Energy Lease is divisible by the Debtor into 27 separate lease agreements. There is no dispute that the text of the Energy Lease contains no clause which grants the Debtor-tenant the right to divide the lease.

The lower courts' reliance upon *Johnson v. Walker*

The bankruptcy judge did not (and could not) cite a specific clause or provision in the Energy Lease which states terms and conditions under which the Debtor might divide the Energy Lease into 27 separate leases. Instead, the bankruptcy judge relied upon the three-pronged test set forth in *Johnson v. Walker*, 824 S.W.2d 184, 187 (Tex. App. – Fort. Worth 1991), to imply such a right. The district judge (following the lead of the bankruptcy judge) applied the following three *Walker* factors as a basis to imply such right: (1) the intent of the parties; (2) the subject matter of the agreement; and (3) the conduct of the parties. [JA 244].

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[6] *Enserch Corp. v. Rebich*, 925 S.W.2d 75, 80 (Tex. App.—Tyler 1996), writ dism'd (Jul 8, 1996).

[7] *Great American Indem. Co. v. Pepper*, 339 S.W.2d 660 (Tex. 1960), reh'g of cause overr. (Nov. 23, 1960).

[8] *Bair v. Voelker Realty Co.*, 589 S.W.2d 867, 869 (Tex. Civ. App.—Dallas 1979).

The Fort Worth Court of Appeals decision in *Johnson v. Walker* arose in the context of a dispute between an insurance agent and the insurance company that had agreed to pay him a commission. Their agency contract had been signed in 1984. The insurance agent asserted his claim for commissions in 1989, some five years later. The insurance company pled the Texas statute of limitations. In response, the agent sought to avoid application of Texas' four–year statute of limitations, by claiming the contract was divisible, such that certain divisible obligations became due within the prior four years. The parties' contract appears to have been silent on the issue of divisibility, so the Fort Worth Court of Appeals applied the three-pronged test relied upon by the courts below to determine whether it should imply a term of divisibility. Upon application of its three-pronged test, the Fort Worth Court of Appeals held the contract was not divisible, and the suit was barred by limitations.

As a preliminary comment, it is important to observe the function of the *Johnson v. Walker* decision within Texas contract law jurisprudence. Neither the *Johnson v. Walker* decision, nor the subsequent Texas court decisions citing *Walker's* three-pronged analysis arose in the context of a contract with respect to which the parties had specifically addressed the issue of divisibility within the "four-corners" of the document. Thus Landlord submits that *Walker's* three-prong divisibility test under Texas contract law functions only as a gap-filler.[9] Other than in the opinions below, *Walker's* three-prong divisibility test has not been used to imply unwritten terms of divisibility in a fully integrated written contract, where the parties expressly agreed upon terms of divisibility.

However, before turning the lower courts' application of *Walker's* three-prong divisibility test as a basis to imply a new term in the Energy Lease, it should be noted that implied covenants and terms are disfavored under Texas law. *See Danciger Oil & Refining Co. v. Powell*, 154 S.W.2d 632, 635 (Tex. 1941). As the Fifth Circuit noted with respect to Texas law in *Scot Properties, Ltd. v. Wal-Mart Stores, Inc.*, 138 F.3d 571, 575-576 (5th Cir. 1998)

> The sublease is a detailed agreement negotiated by sophisticated parties with the assistance of counsel, and we cannot conclude that the new terms suggested by Scot were contemplated by the parties but inadvertently left out of the agreement.
>
> "[i]t is not enough to say that an implied covenant is necessary in order to make the contract fair, or that without such a covenant it would be improvident or unwise, or that the contract would operate unjustly."

As will be further developed in Argument 2 herein, the parties specifically bargained with respect to divisibility. An inspection of the 39-page Energy Lease confirms it is not plausible that the parties simply forgot to include a right of divisibility of the Energy Lease at the option of the Debtor. The lower courts did not reason that the parties inadvertently left out a right in favor of the Debtor-tenant to divide the Energy Lease. Indeed, the "abandonment default" clause discussed herein at page 17 is plainly inconsistent with such a right. Even the bankruptcy judge noted this abandonment-default clause was inconsistent with a right to divide the lease, but simply held that it was "outweighed" by others. [JA 223].

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[9] A "gap-filler" is a term supplied by the courts either because the court feels that the parties would have agreed upon the term if it had been brought to their attention or because it is a term which comports with community standards of fairness and policy. See Restatement (Second) of Contracts § 204 (1981).

Accordingly, while Landlord agrees that *Walker's* three-prong divisibility test is a valid method of determining contract divisibility where a contract is silent on the issue, Landlord submits that the lower courts reliance on *Johnson v. Walker* in this context to imply a term of divisibility was in error.

Where, as here, the parties specifically address the issue of divisibility in the contract, there can be no question that the parties intend for the contract's terms to dictate if and when the contract or lease may be divided.[10] Only in the absence of express divisibility provisions, should a gap-filler, such as the *Johnson v. Walker* test be applied. Nevertheless, Landlord will show that even under the three-pronged *Walker* test relied upon by the courts below, the orders below are in error.

Intent of the parties

In reaching his conclusion as to the parties' intent, the bankruptcy judge simply referenced several provisions of the Energy Lease that he concluded demonstrated its divisibility.

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[10] The parties express agreements on divisibility will be examined further in Argument 2 herein.

The bulk of these provisions concern extraordinary contingencies such as a condemnation, destruction or sale of property covered by the Energy Lease. The bankruptcy judge concluded that since the parties agreed in advance to a rent reduction amount for each property in these extraordinary circumstances, they intended that each property be leased pursuant to its own separate lease.[11] The other provision the

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[11] It is undisputed that the parties agreed upon the formula for a rent reduction in Section 1.8 of the Energy Lease. However, the bankruptcy judge seems to enlarge the actual agreement, stating:

> "Moreover, following the execution of the Energy Lease, the parties agreed upon a schedule (page 2 of Debtors' "Exhibit B") which specifically and on a property-by-property basis detailed the amount of the annual and monthly rent allocated to each of the 27 properties." [JA 221].

The bankruptcy judge appears to have been under the erroneous impression that such "Exhibit B" constitutes an amendment to the Energy Lease. To the extent that this is a fact finding, it is clearly erroneous, as there is no evidence in the record to support a finding that the parties had "agreed upon a schedule." Indeed, the evidence reflects that "Exhibit B" is not part of the Energy Lease agreement. The Landlord testified:

> Q. And once again, to your knowledge, is page 2 of the Debtors' "Exhibit B" contained anywhere in the Energy Lease between USRP and Gant Acquisition?
>
> A. No. [JA 123].

No evidence was presented that "Exhibit B" was ever signed by the Landlord. It is an express requirement of the Energy Lease that any modification or amendment of the Energy Lease must be evidenced by a writing signed by the Landlord. *See* Energy Lease at Section 18.4. [JA 50]. Mr. Don Draughn, the Debtor's witness who sponsored "Exhibit B," did not testify that it represented an "agreement" between the parties. Rather, "Exhibit B" was offered as the Debtor's calculation of the rent reduction that the Debtor understands would be applicable in the event of a condemnation or sale of one of the stores. There is not a scintilla of evidence that the parties agreed to amend the Lease Agreement per the bankruptcy judge relied upon in reaching his conclusion was a provision of the Energy Lease that dictated that a default on the part of one of the "landlords" did not constitute a default by the others.[12]

The bankruptcy judge's narrow focus in ascertaining the intent of the parties brings to mind the adage about a person who "can't see the forest for the trees." By focusing on a few extraordinary contingencies (such as condemnation of one of the premises), the bankruptcy judge failed to enforce the fundamental bargain that had been struck by the parties. Their bargain of a single, integrated lease is clearly expressed throughout the Energy Lease.

First, it is noteworthy that the opening sentence of the Energy Lease refers to "this Lease" and not to "these leases."

Second, the "rent" payable under the Energy Lease is not a fluctuating number calculated with reference to the actual number of stores that the Debtor chooses to operate. Rather, it is based upon a constant, being the historic

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schedule marked as Debtor's "Exhibit B." "Exhibit B" is discussed at pp. 11, 13, 19, 20, 24, 46, 51, 52, 53, 54, and 56 of the Transcript, and at no point was it characterized as an "agreement." [JA 80, 82, 88, 89, 93, 115, 120, 121, 122, 123, 125]. If one of the conditions precedent for a rent reduction occurred, such as the condemnation or sale of one of the premises as required by Section 13.5 of the Energy Lease, the Landlord concurs that "Exhibit B" correctly applies the method the parties agreed to follow to determine the amount of the rent reduction. However, it was error for the bankruptcy judge to treat "Exhibit B" as some type of "agreement" by the parties to amend the Energy Lease. This factual error appears to have contributed to his erroneous conclusion that the Energy Lease is divisible.

[12] Significantly, the Energy Lease refers to and defines the six affiliated USRP limited liability companies as a single "Landlord," not as individual landlords. [JA 26].

purchase price paid by the Landlord for all 27 stores. This is reflected in the following terms of the Energy Lease:

> 3.1 Tenant shall pay to Landlord as rent for the Leased Property the sums shown on Exhibit D, payable in advance, without deduction, offset, prior notice or demand, only by ACH Transfer, and Tenant shall execute the ACH Authorization Form attached hereto as Exhibit F.
>
> Exhibit D entitled "Rent Schedule" then expresses the Base Rent amount as follows: "The annual Base Rent for the Lease Property shall equal the product of (i) 11.375% multiplied by (ii) the Capitalized Cost.

The term "Capitalized Cost" is defined in the Energy Lease as follows:

> 1.10 Capitalized Costs. The Capitalized Costs are the sum of (i) the purchase price under the Purchase Agreement for the Leased Property of $13,000,000.00, plus (ii) Landlord's expenses under the Purchase Agreement in obtaining title commitments, title policies, surveys, environmental and engineering reports, deed stamp or transfer taxes and recording costs, for each Licensed Property.[13]

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[13] This aggregate purchase was later agreed to be $13,075,000.00 in the First Amendment to Purchase and Sale Agreement dated July 29, 1999, as noted in the Memorandum Opinion at page 3. See also Landlord's testimony on this issue. [JA 104]. The Landlord asserts the current monthly base rent is $130,930.80.

Under Texas law, the essential feature of a divisible contract is that a portion of the price is set off against a portion of the performance; therefore, when a part of the performance has been rendered, a debt for that part immediately arises.[14] However, the rent obligations under the Energy Lease were not performable in "parts" (i.e. rent for first 5 stores, then for next 10, etc.). Rather, the rent obligations became due for all 27 stores at the inception of the lease and thereafter on a monthly basis.

Since the monthly rent amount is a function of the historic constant of $13,075,000, and is calculated without regard to which of the 27 stores are being occupied, the intent of the parties to have made a single, integrated lease is manifest.

Third, the abandonment-default clause evidences the parties' intent that the Energy Lease be a single, integrated transaction. The abandonment-default clause denies the tenant the option to simply abandon certain unwanted premises. The Energy Lease provides:

> 17.1 Default. The occurrence of any of the following shall constitute a material default and breach of this Lease by Tenant:
>
> (a) Any failure by Tenant to pay the rent or any other monetary sums required to be paid hereunder (where such failure continues

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[14] *F.D. Stella Prods. Co. v. Scott*, 875 S.W.2d 462, 466 (Tex. App.—Austin 1994). *See also Ferguson v. John Q. Hammons Co.*, 183 B.R. 122, 125 (Bankr. N.D. Tex. 1995) ("A contract is divisible when the performance by one party consists of several distinct and separate items and the price paid by the other party is apportioned to each item.").

> for ten (10) days after written notice by Landlord to Tenant);
>
> (b) The abandonment or vacation of any Leased Property by the Tenant or the sale by Tenant of all or a part of the business operated by Tenant at the Leased Property, unless pursuant to a permitted assignment or sublease pursuant to Section 15, or pursuant to a temporary cessation of business due to casualty or remodeling;[15] [JA 46].

If the parties had intended to make 27 separate leases, it is inexplicable that the Debtor would agree that its abandonment of one property would permit the Landlord to evict the Debtor from the other 26 premises. Clearly, the parties substantive bargain was a single, integrated lease.

Even if the parties' intent to have a single lease agreement were not evident from the clear language of the Energy Lease, so Texas law would permit the courts to "construe" the parties' intent, the uncontradicted oral testimony of the Landlord on the issue of intent demonstrates that the Landlord would not have entered into the lease transaction absent the single, indivisible character of the Energy Lease. The Landlord's testimony below confirms that the Landlord considered the single package of 27 premises to provide a materially greater credit-worthy transaction than would have been presented with 27 separate leases. Arthur Nienhueser, II ("Nienhueser"), employed as a senior credit officer and later as consultant to the Landlord, testified concerning the Landlord's intent to enter into an indivisible contract. Nienhueser testified:

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[15] The debtor's rejection of the "leases" is tantamount to a decision to abandon the leases resulting in a default under this clause, see *In re Reed*, 94 B.R. 48 (E.D. Pa. 1988)(rejection results in abandonment of lease); *In re Rodall*, 165 B.R. 506 (Bankr. M.D. Fla 1994)(same).

> Q. ...Can you tell us what is referenced in 17.1A and B?
>
> A. Well 17.1 is the definition of what events create a default in the lease, and one of those is failure by tenant to pay rent, and – – and the – – –
>
> Q. – – – What about 17.1B? What does that provide?
>
> A. The abandonment or vacation or vacancy of any individual property by the tenant, or by the sale by tenant.
>
> Q. Okay.
>
> A. Without our – – without USRP's approval.
>
> Q. And what is – – under this lease what was USRP entitled to do if there was an event of default?
>
> A. Oh, it – – it's a – – a cross-collateral provision that allows us to cause the entire lease to go into default, and it – – it represents for us a credit enhancement that the – – we would not have done this transaction without the ability to cause the entire transaction to go into default for one or two stores to go dark. It's just like the guarantee required by U.S. – – Convenience USA, and it's a credit enhancement to entering into the transaction.

[JA 105-106].

The Debtor's testimony confirms that the Energy Lease was a single transaction designed to permit the acquisition of the 27 properties. Don Draughn ("Draughn"), Chairman and CEO of the Debtor, testified:

> Q. ...Was there ever any discussion of leasing less than 27 leases -- 27 premises?
>
> A. I mean, that was -- no, because that was the number of stores we were acquiring.
>
> Q. So was it a package deal?
>
> A. I mean, like -- like I -- as I said earlier, I saw it as a financing mechanism.
>
> Q. To finance the purchase or for -- to finance these 27 stores? Correct?
>
> A. Correct. [JA 91].

In applying Texas law on the question of the parties' intent, a United States bankruptcy judge for the Northern District of Texas concluded that testimony as to the parties' willingness to enter into an entire or divisible contract is relevant to the determination of divisibility. *Ferguson v. John Q. Hammons Co.*, 183 B.R. 122, 126 (Bankr. N.D. Tex. 1995). The above uncontroverted testimony establishes that the parties considered the Energy Lease to be a single, indivisible contract.

Texas law holds, "if it appears that the contract was to take the whole or none, then the transaction would be entire." *Frankfurt Fin. Co. v. Treadaway*, 159 S.W.2d 514, 516 (Tex. Civ. App. - Dallas 1942, writ ref'd w.o.m.). Mr. Nienhueser's crucial testimony on this point was completely ignored by the bankruptcy judge in his Memorandum Opinion. The undisputed evidence establishes that the Landlord would not have entered into the Energy Lease but for the fact that it encompassed all 27 properties. Therefore, the Energy Lease cannot be deemed to be divisible into 27 separate leases.

The bankruptcy court's construction of the "abandonment-default" clause violates other well established Texas contract law principles. The bankruptcy judge recognized that paragraph 17.2(b) permitted the Landlord to terminate the tenant's right to possession "of one or more (including all)" of the leased properties in the event of a default. [JA 223]. The bankruptcy judge simply characterized this provision as a "cross default" clause (notably, this is an outcome determinative label that implicitly assumes multiple leases; absent multiple leases there can be no cross-default) and determined that it was "insufficient to outweigh the other provisions." *Id.* Accordingly, the bankruptcy judge concluded that the parties intended that the Energy Lease be divisible.

The bankruptcy judge's proposed "balancing test" method of contract construction is not recognized under Texas law, and the judge cited no cases in support of such method. Under Texas law, courts are not free to simply ignore contractual provisions that seem to be "outweighed" by others, rather Texas courts are charged with the duty to harmonize and enforce each and every clause of a contract. It is presumed that every provision in the agreement was placed therein for a particular purpose[16] as, generally, parties to an instrument intend every clause to have some effect and in some measure to evidence their agreement.[17] Under Texas law, a court has no right to nullify any terms of the agreement[18] and must avoid the adoption of a construction that would render any provision meaningless.[19] Texas courts follow "[t]he presumption . . . that all stipulations in a contract are dependent, and a promise will be so regarded in case of doubt." *Treadaway*, 159 S.W.2d at 516. "A contract is indivisible when by its terms, nature, and purpose it contemplates and intends that each and all parts and the consideration shall be common to each other and interdependent." *Summers v. Welltech, Inc.*, 935 S.W.2d 228, 232 (Tex. App. – Houston [1st Dist.] 1996, no writ). Accordingly, all provisions of the Energy Lease should have been construed as interdependent, including the "abandonment-default" clause.

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[16] *N.M. Uranium, Inc. v. Moser,* 587 S.W.2d 809, 814 (Tex. Civ. App.—Corpus Christi 1979), writ ref'd n.r.e. (Feb. 13, 1980).

When scrutinized, the decision of the bankruptcy judge hinges almost entirely upon the fact that the parties could apportion a rent reduction credit between the properties, in narrowly defined contingencies. However under Texas law, "[t]he mere fact that there is a contract rate of payment specified per each unit of performance does not make the contract divisible." *Johnson v. Walker*, 824 S.W.2d at 187(citing *Coon v. Schoeneman*, 476 S.W.2d 439, 440 (Tex. Civ. App. – Dallas 1972, writ ref'd n.r.e.)). It is well established that the inclusion of a rate of payment per unit of performance does not make the contract divisible, "since the parties may not have been willing to contract separately for each unit." *Coon v. Schoeneman*, 476 S.W. 2d 439, 443 (Tex. Civ. App.—Dallas 1972, writ ref'd n.r.e.). Texas law recognizes, even if the consideration can be apportioned, that "if there is a single assent to a whole transaction involving several things, a contract is entire, but if there is a separate assent to each of the several things involved, it is divisible." *Id.* The uncontroverted evidence establishes the parties' single assent. Even the bankruptcy judge acknowledged "there apparently was a single assent by the multiple parties of the lease." [JA 218].

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[17] *Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515, 518 (Tex. 1968), reh'g of cause overr. (Oct. 30, 1968). *See also* Restatement (Second) of Contracts § 204 (1981).

[18] *Nicholson v. Lieber,* 153 S.W. 641 (Tex. Civ. App.—San Antonio 1913), mod on other grounds, 206 S.W. 512 (Tex. Com. App.).

[19] R&P Enterprises v. LaGuarta, Gavrel & Kirk, Inc., 596 S.W.2d 517, 519 (Tex. 1980).

Also illustrative is the bankruptcy judge's reliance upon the following clause to buttress his erroneous conclusion that the Energy Lease constituted 27 separate leases.

> 18.24 Separate Lease Agreements. A Landlord may, from time to time, sell one or more of the Premises or any part hereof, and Tenant agrees, in connection with such sale, to execute a new lease agreements ("new lease") with the purchaser. In connection with the new lease, this Lease will be amended to delete the Premises subject to the new lease, and the rental obligation hereunder will be reduced by the rental amount allocated to the new lease. Notwithstanding the foregoing to the contrary, in no event will Tenant's overall rent obligation be increased in connection with the execution of a new lease.

The bankruptcy judge cites this provision in support of his conclusion that the "Separate Lease Agreement" clause "strongly reflect[s] an intent that the lease be divisible." [JA

219]. However, this clause applies only in the event of a future sale of one of the premises, at the option of the Landlord (not the Debtor). The express condition for the "Separate Lease Agreement" clause to apply has not yet occurred. It is the role of the court to enforce the parties' bargain, not to make a different bargain. Further, the fact that the parties recognized that in the future some of the 27 properties might be sold, removed from the Energy Lease, and made subject to new leases between the Debtor and the new owners, refutes the notion that at present they are parties to 27 leases. Indeed, if at present, the Landlord and the Debtor are parties to 27 lease agreement, the "Separate Lease Agreements" clause serves no purpose whatsoever in the Energy Lease. Under Texas law, a written contract must be considered as a whole and each part should be given effect.[20] All language of the contract is presumed to have some meaning and is not regarded as mere surplusage; the court may not disregard language unless it is necessarily repugnant to other language in the contract.[21] The bankruptcy judge erred by adopting a construction of the Energy Lease which renders the "Separate Lease Agreement" Section 18.24 as surplusage.

Federal Courts, which are duty bound to apply Texas law on the construction of a contract governed by Texas law, have likewise held that the parties' intent is the principal determinant of divisibility. *See Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 739 (5th Cir. 1996). Here, a fair reading of the entire Energy Lease, coupled with the uncontroverted testimony of Mr.

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[20] *Nevels v. Harris*, 102 S.W.2d 1046 (Tex. 1937), 109 ALR 1464.

[21] *R.H. Sanders Corp. v. Haves*, 541 S.W.2d 262, 264 (Tex. Civ. App.—Dallas 1976).

Nienhueser, demonstrates the parties' clear intent to make an integrated, interdependent lease transaction of 27 properties under a single Energy Lease.

Subject matter of the agreement

As noted above, *Johnson v. Walker* allows the court to examine the "subject matter" of the agreement.[22] The bankruptcy judge's discussion of the "subject matter" of the Energy Lease was limited to his observation: "In the present case, that subject matter consists of 27 separate and distinct convenience stores located in 18 different cities and scattered over a wide area of North Carolina." [JA 14]. From this fact alone, the bankruptcy judge concluded that the second factor of "subject matter" favored divisibility.

However, properly interpreted, the subject matter of the Energy Lease is a group of Buildings and Leased Property, the possessory rights to which were conveyed under a single leasehold grant. The opening paragraph of the Energy Lease provides:

> For and in consideration of the rental and of the covenants and agreements hereinafter set forth to be kept and performed by Tenant, Landlord hereby leases to Tenant and Tenant hereby leases from Landlord, the Building or Buildings and the Leased Property as defined below, for the term and at the rental amount, and subject to and upon all of the terms, covenants, and agreements hereinafter set forth.

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[22] Again, Landlord views *Johnson v. Walker* as a "gap filler," and that its three-pronged test is not required in this context where the parties negotiated divisibility issues.

"Buildings" and "Lease Premises" are defined as the entire group of Buildings, not as divisible units.

> 1.1 Building. As used in this Lease the word "Building" shall mean any of the twenty-seven (27) one-story buildings occupied by a convenience store, gas dispensary and/or car wash, located on the tracts of land more particularly described on Exhibit A. Tenant shall be responsible for obtaining all underground storage tanks, equipment, multi-pump dispensers, and personal property at the Premises and signage.
>
> 1.4 Leased Property. The word "Leased Property" as used in this Lease shall mean collectively, the Building or Buildings, the Premises and the Personal Property with respect to each convenience store leased hereunder.

Does the fact that a contract concerns a sale of 5 widgets, in contrast to a contract that concerns the sale of one widget, *ipso facto* favor severability? The answer is "no" under Texas law. Texas courts hold that: "[t]he mere fact that there is a contract rate of payment specified per each unit of performance does not make the contract divisible." *Johnson v. Walker*, 824 S.W.2d at 187 (citing *Coon v. Schoeneman*, 476 S.W.2d 439, 440 (Tex. Civ. App. – Dallas 1972, writ ref'd n.r.e.)). Accordingly, the bankruptcy judge's "subject matter" focus should have been on whether the Energy Lease contained two or more independent rights and duties. Instead, he erroneously concluded the "subject matter" test favored divisibility because the lease involves "multiple properties."

The Fifth Circuit's *Stewart Title* case provides an application of the "subject matter" principle in assessing the severability of a contract. *See Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 739 (5th Cir. 1996). At issue was a 32-year lease agreement concerning personal property in a title abstract plant. The abstract plant contained abstracts, records, files, computers, stored material and other property necessary to a title insurance and abstract business. The Fifth Circuit observed that the "Use Rights" and "Reproduction Rights" referenced in the lease involved distinct and separate subject matters. The Use Rights permitted the lessee to use the abstract books, records and equipment of the plant but not to "duplicate in any manner any material constituting any part of said plant or permit anyone to make copies therefrom." In contrast, the Reproduction Rights -- the privilege to make copies after termination -- served as the natural complement to the Use Rights. The Fifth Circuit observed that in exchange for the two sets of rights, the lessee agreed to provide two kinds of consideration: (1) monetary outlays of $3,000/month rent for the Use Rights, and (2) additions to the plant in the form of daily posting of new information for the Reproduction Rights.

Assessing the "subject matter" factor, the Fifth Circuit observed that although these two separate agreements were encompassed in the same lease document, they were distinct and clearly defined. One dealt with the use but not the reproduction of the abstract materials, and the other dealt with the reproduction of only the abstract materials added since execution of the lease. It is noteworthy that the lessee's rights concerning the Reproduction Rights expressly survived the termination of the lease.

In contrast, the Energy Lease does not provide separate and distinct rights and duties as presented in the

Stewart Title case. For example, the duty to pay rent is based upon a fixed historic purchase price figure of $13,075,000. If only half of the total rent is paid, the Debtor does not have a right to possess half of the 27 properties. If the Landlord terminates the Energy Lease, the Debtor does not have rights to possess any of the 27 premises after termination.

Conduct of the parties

The third *Johnson v. Walker* factor the bankruptcy judge considered is whether the "conduct" of the parties supports a finding that the lease is divisible. The most probative evidence on the "conduct" factor is the undisputed fact that historically a single rent payment has been made each month to the Landlord, not 27 separate rent payments.

> Q. There has been some testimony about the method of payment, Mr. Nienhueser.
>
> Do you know how – – prior to the petition of bankruptcy, how the payments were made?
>
> A. Yes. Under the authorization to – – for an ACH authorization, U.S. Restaurant Properties was granted authority to – – for us to create an ACH to their master account at Bank of America, which I believe is a Convenience USA account.
>
> Q. And where did that deposit go at USRP?
>
> A. That deposit went to an account that we have, which is a concentration account, which I think in the beginning, at the time, was a concentration account required by our lender.
>
> Q. Were there 27 different deposit accounts?

A. No, there was a single account, single transfer once a month.

Q. Well, there are six different deposit accounts. Right?

A. No, there was a single account.

[JA 106].

The bankruptcy judge acknowledged that the Debtor paid rent by means of a single payment. However, the bankruptcy judge placed no weight on this fact. Instead, he cites a "schedule" that "specifically set forth an allocation of rent to each of the properties." [JA 225]. This appears to be a reference to the Debtor's "Exhibit B." [JA 64-65]. As noted in footnote 10, there is no evidence that "Exhibit B" represents an amendment to the Energy Lease. No evidence was presented that any of the contingencies (e.g., condemnation) had occurred, which would permit the Debtor to reduce its rent obligation. Yet based upon this contingent rent reduction schedule, the bankruptcy judge concluded that the third "conduct" factor favored divisibility.

In sum, the only "conduct" evidence in the record is a single "base rent," paid monthly, and calculated by reference to the historic $13 million historic purchase price. There was no "conduct" type evidence presented of "multiple lease" payments, or that the parties treated the Energy Lease as multiple leases. There is no evidence that the parties agreed to include "Exhibit B" as an amendment to the Energy Lease, or that they changed their conduct prior to the bankruptcy case in reliance upon "Exhibit B." Thus the bankruptcy judge's application of the "conduct" factor was in error. The district judge's analysis of the issues, was limited to whether the bankruptcy judge had made a plausible application of *Johnson v. Walker.*

Conclusion

The district judge's conclusion that the Energy Lease should be construed as 27 separate unexpired leases is in error. The district judge's order fails to address how the "abandonment default" clause can be reconciled with the concept the Energy Lease is divisible at the option of the Debtor. Even under the three-pronged *Walker* test (assuming such gap-filler is needed in this context) the record shows is only one single lease, which must be assumed or rejected *in toto*. The District Court's Order below affirming the bankruptcy judge's orders authorizing the "rejection" of twelve "unexpired leases" should be reversed.

Argument 2: The bankruptcy judge erred in his application of "divisibility" principles to remake the parties' bargain.

Principles of contract divisibility do not trump the doctrine of "freedom of contract," and that the role of courts is to give effect the intent of the parties.[23] However, rather than enforcing their written bargain, the bankruptcy judge's goal was to determine whether the Energy Lease is or is not a divisible contract. The bankruptcy judge's Memorandum Opinion implicitly adopts a rigid "either/or" principle of contract divisibility. Much of the Memorandum Opinion is focused on citation of clauses that either support a conclusion that the contract is divisible, or which support a conclusion to the contrary. Pointing to instances where the Landlord has rights to sever certain of 27 stores, the bankruptcy judge labels the entire Energy Lease a "divisible contract." [JA 226]. However, from this label of "divisible," the bankruptcy judge then implies a new term that this divisible contract should be divisible at the option of both parties. This is an unwarranted leap. Under the "freedom of contract" doctrine, contracting parties are permitted to make any of the following four agreements concerning the divisibility of their contracts.

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[23] The "freedom of contract" principle has long been a foundation of Texas contract law jurisprudence, see *Wood Motor Co. v. Nebel*, 238 S.W.2d 181, 185 (Tex. 1951).

Agreement 1: The contract not divisible by either the Landlord or the Tenant.
Agreement 2: The contract is divisible by the Landlord, but not the Tenant.
Agreement 3: The contract is divisible by the Tenant, but not the Landlord.
Agreement 4: The contract is divisible by both the Landlord and the Tenant.

While it might be correct to label Agreements 2, 3, and 4 as "divisible," this label begs the questions of (i) divisible by which party, and (ii) divisible under what terms and conditions? Under the bankruptcy judge's holding, parties really are not free to make a contract that is divisible only at the option of the one party. Once the "divisible" label was attached to the Energy Lease, that label was given legal significance by the bankruptcy judge that trumps the parties' actual agreement.

The Landlord submits that under Texas law, contracts are not interpreted under this rigid "either/or" rule of divisibility. Texas law does not mandate that contracts must be either divisible by both parties or divisible by neither party. If the Landlord and the Tenant agree that the Landlord has the right to sever certain of its obligations under a contract into a new contract, but that the Tenant has no severance rights, Texas law requires courts to enforce the parties' bargain, rather than some "divisible" label assigned to the contract.

Here the parties clearly negotiated and reached agreement on terms of divisibility. The *Johnson v. Walker* gap-filler test was not required to give effect to their agreement. As shown below, the Energy Lease grants the Landlord future divisibility rights, and grants the Debtor certain protections in the event that the Landlord exercises such rights. The Debtor is not granted reciprocal divisibility rights under the Energy Lease. This aspect of the parties' written bargain is evidenced in the following clause of the Energy Lease:

> 18.24 Separate Lease Agreements. A Landlord may, from time to time, sell one or more of the Premises or any part hereof, and Tenant agrees, in connection with such sale, to execute a new lease agreements ("new lease") with the purchaser. In connection with the new lease, this Lease will be amended to delete the Premises subject to the new lease, and the rental obligation hereunder will be reduced by the rental amount allocated to the new lease. Notwithstanding the foregoing to the contrary, in no event will Tenant's overall rent obligation be increased in connection with the execution of a new lease. [JA 54].

This "Separate Lease Agreements" section records the parties' intent on several issues. First, it grants the Landlord the right to sell one or more of the leased Premises in the future. Otherwise, the Landlord would have to find a buyer for all 27 Premises, who would assume all of the Landlord's duties under the Energy Lease. To accomplish a sale of one or more of the Premises, this section 18.24 grants the

Landlord (not the Debtor) the right to divide the lease into "separate lease agreements." However, it also contains the following provision protective of the Debtor: "in no event will Tenant's overall rent obligation be increased in connection with the execution of a new lease."

The last sentence of this section confirms the Debtor was unwilling for the Landlord to be in a position to divide the Energy Lease in a manner which would result in a higher monthly rent. If the lease is to be divided in the future, the Debtor has bargained for a "constant rent protection." The "Separate Lease Agreements" section places a "ceiling" on the rent that can be charged in the event the Landlord divides the Energy Lease.

Likewise, the Landlord bargained for a "floor" on the amount of rent to be paid by the Debtor, even if the Debtor decides that not all 27 Premises are necessary for its operations. As noted above, the rent due is calculated by reference to an historic constant, and not by reference to the number of stores in operation. Certainly, the Debtor would have preferred the option to abandon unprofitable stores, and reduce its rent obligations with respect to such abandoned Premises. However, the text of the Energy Lease reflects that the Landlord also bargained for a "constant rent protection" such that abandonment of one or more the Premises is not a basis for the Debtor to reduce its monthly rent obligation. This is evidenced by the abandonment-default clause. If the Debtor unilaterally chose to close stores and reduce rent, Landlord can claim an event of default. *See* Energy Lease at section 17.1(b). [JA 46].

The bankruptcy judge seized upon the Landlord's limited right to divide the Energy Lease upon a sale of one of the stores, as a basis to declare the entire Energy Lease as "divisible." Then using this "divisible" classification, the bankruptcy judge proceeded to render nugatory the "abandonment-default" provisions of the Lease which denies the Debtor the option to close stores and reduce its rent, if the Debtor decides to cease operations at one or more of the Premises. In substance, the bankruptcy judge has used "severability" principles to remake the parties' bargain in a manner that honors the rent "ceiling" term beneficial to the Debtor, but eliminates the rent "floor" term beneficial to the Landlord. The bankruptcy judge has used "divisibility" principles not as an analytical tool to determine the parties' intent, but rather as a means to remake the parties' bargain. In essence, the bankruptcy judge has remade the Energy Lease into a "heads we win, tails you lose" bargain beneficial to the Debtor.

Without question, the bankruptcy judge created more value for the bankruptcy estate by construing the Energy Lease as separate leases, each of which the Debtor may then assume or reject under Section 365 of the Bankruptcy Code. However, that additional value for the estate comes at the expense of the Landlord, and nothing in Texas law permits a court to ignore or override the parties' intent in order to assist the Debtor's reorganization effort. The bankruptcy judge's erroneous application of Texas contract law resulted in a completely different agreement than the parties intended. There is no federal law based rule that permits the bankruptcy judge to label the Energy Lease as "divisible" as a means to achieve value that would not exist outside of bankruptcy. The text of the Section 365 of the Bankruptcy Code does not include such a federal law rule. Further, the U.S. Supreme Court has admonished against reliance upon federal law "equitable" rules that result in "a windfall merely by reason of the happenstance of bankruptcy." *See Butner v. U.S.*, 440 U.S. 48, 55 (1978). Here, the Debtor and its estate has received such a windfall: as a result of the happenstance of bankruptcy, the Debtor has been allowed to divide a lease that the parties agreed would be indivisible by any party other than the Landlord. This result is plainly at odds with *Butner*.

In sum, nothing in Texas law prohibits parties to a contract from agreeing upon terms and conditions under which certain of their duties may be severed into a new contract in the future. This is precisely the situation under the Energy Lease where the Landlord was given the right to sell one or more of the properties in the future. The Landlord may require of the Debtor a new separate lease agreement in conjunction with such sale. While the "divisibility" principle may come into play in the interpretation of such contractual provision, such principle does not permit a court to nullify other provisions of the agreement.[24] No "public policy" principle limits parties' ability to agree to a contract which grants one party the right to divide the contract, but denies such right to the other party. Texas contract law does not allow "divisibility" principles to trump the actual intent of the parties as expressed by their unambiguous instrument. Ascertaining the "true intent of the parties, as expressed by their written instrument" remains the primary concern of Texas law. *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, 925 S.W.2d 565, 574 (Tex. 1996), reh'g of cause overr. (Aug. 16, 1996). The record in this case, consisting of the text of the Energy Lease, and the testimony of witnesses, confirms the parties did not intend that the Debtor would have the right to abandon one or more of the Premises, and unilaterally reduce the rent payable to the Landlord. Yet as a result of the orders below, the Debtor has been allowed to pay a reduced monthly rent of $82,734.25, instead of the $130,930.80 due under the Energy Lease. The bankruptcy judge's application of "divisibility" principles to remake the parties' bargain is clear error.

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[24] A review of the leading Texas case law concerning divisibility principles, indicates that in no instance has a Texas court relied upon divisibility principles to nullify other portions of the contract. Rather, divisibility principles were relied upon in assessing limitations claims, and claims of liability in the context of a partially performed contract. *See Johnson v. Walker*, 824 S.W.2d 184 (contract held not divisible in a limitations context); *Wellington R. Committee v. Crawford*, 216 S.W.2d 151, 155 (Tex.Com.App. 1919) (no liability under partially performed contract which was indivisible); *F.D. Stella v. Scott*, 875 S.W.2d 462 (relies upon divisibility principles to determine limitations period).

Argument 3: Even if the Energy Lease could be construed as 27 separate leases, the bankruptcy judge erred in disregarding the "abandonment-default" clause.

Even if the Fourth Circuit were to affirm the district judge's conclusion of law that the Energy Lease constitutes 27 separate lease transactions, there remains the issue of the abandonment-default clause. The Debtor has been permitted to reject 12 of the supposed 27 "separate leases," and to assume and assign the rest. Implicit in the Debtor's business judgment that it should reject 12 stores is a belief that the Debtor (or its assignee) will not have to pay the rent on the 12 stores whose supposedly "separate leases" have been rejected. This is an incorrect assumption.

The Bankruptcy Code gives a trustee or debtor in possession the power, subject to court approval, to assume executory contracts and unexpired leases. The power to assume is as important as the power to reject in that it allows the trustee or debtor in possession to take full advantage of favorable contracts and leases.

The power to assume, however, is not without restrictions. An important restriction—designed to protect the rights of the nondebtor party to the agreement—is that the trustee or debtor in possession must, with limited exceptions not applicable here, cure defaults or give adequate assurance that defaults will be cured promptly.25

It is common for parties with multiple agreements to provide that a default of an obligation under one agreement, in and of itself, will constitute a default under a different agreement. Obviously, the Landlord contends that the Energy Lease is only one lease, not multiple leases. Nonetheless, if the Fourth Circuit were to affirm the bankruptcy judge's construction, that would leave the parties with 27 lease agreements with an "abandonment-default" clause (in paragraph 17.2(b)) common to each. Under such construction, the "abandonment-default" clause would function like a "cross-default" clause functions in true separate agreements. The question becomes whether the Debtor may assume the 15 remaining leases, without curing defaults under the "abandonment-default" clause related to the 12 rejected stores.

The bankruptcy judge has answered this question in the affirmative. The Memorandum Opinion states:

> It having been determined in the present case that the Energy Lease is divisible into separate leases, the issue of whether the Debtors may reject six of those unexpired leases at this time is a matter of federal law involving the application of § 365. . .
>
> In the bankruptcy context, it is well established that cross-default provisions do not integrate executory contracts or unexpired

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[25] *See* 11 U.S.C. § 365(b).

> leases that otherwise are separate or severable. (emphasis added)
>
> [JA 226-227].[26]

The Landlord would show that such proposed "federal law" rule is not "well established" in our jurisprudence. Various bankruptcy courts have confronted the question of whether, as a condition to assuming an executory contract or unexpired lease containing such a "cross-default" provision, the trustee or debtor in possession must cure a default of an obligation arising under a separate contract.

This issue was examined in *In re Kopel,* 232 B.R. 57 (Bankr. E.D.N.Y. 1999), a case in which the bankruptcy judge upheld a cross-default provision in a commercial lease so that the debtor in possession could not assume the lease without curing defaults under a promissory note and consulting agreement. In connection with the *Kopel* transaction, the parties entered into several agreements in addition to a veterinary practice asset acquisition agreement, all signed on the same day. Martin Kopel issued to Campanile a promissory note representing $350,000 of the

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[26] Under the same rationale the bankruptcy judge later authorized the Debtor to reject six more stores. Then on February 12, 2003, the Bankruptcy Court issued an Order Confirming Debtors' Amended Joint Plan of Reorganization Under Chapter 11 (the "Confirmation Order"), without requiring the Debtor to cure the defaults arising with respect to these 12 rejected stores. As a result of the erroneous orders below, the Debtor's assignee, under color of law, has been permitted to occupy of remaining 15 premises after payment of only 63.18% of the monthly base rent to the Landlord (the current base rent is $130,930.80 monthly. By reason of the orders below the Debtor and its assignee have been allowed to pay rent $82,734.25 per month and to disregard the contractual obligations arising under the abandonment-default clause with respect to the 12 premises that supposed have been "rejected."

$425,000 purchase price. They also signed a 15-year commercial lease with Kopel as tenant and Overbaugh as landlord, and a consulting agreement which provided for Campanile to act as a consultant for Kopel for an annual salary and which also restricted Campanile's ability to compete with Kopel. The asset acquisition agreement stated that the execution of each of these documents was an express condition precedent to the closing of the sale.

A cross-default provision was inserted in each agreement so that if Kopel defaulted under any one of the agreements, it would constitute a default under all agreements and Campanile would be able to recapture the veterinary practice as a whole. According to Campanile's affidavit, he feared that Kopel might default under the agreements and, therefore, Kopel's acceptance of the cross-default provisions was the principal inducement for Campanile to go forward with the transaction.[27] Campanile believed that the only way to recover full value of the veterinary practice in the event of default would be to quickly step in and operate the business.[28]

The bankruptcy judge in *Kopel* recognized as axiomatic the principle that an executory contract must be rejected or assumed in its entirety—a debtor cannot assume parts of a contract while rejecting the other parts. However, the judge also noted an exception to the all-or-nothing rule that could justify not enforcing a particular contract provision notwithstanding assumption of the contract:

> In limited circumstances, . . . a court may exercise equitable discretion to refuse to

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[27] This is very similar to the testimony given by Mr. Nienhueser at the hearing below. Transcript at pp. 36-37. [JA 105-106].

[28] *Id.* at 62.

> enforce a provision where "there is not substantial economic detriment to the [non-debtor counterparty] shown and where enforcement would preclude the bankruptcy estate from realizing the intrinsic value of its assets.[29]

Courts that have considered whether a cross-default clause is enforceable in the context of a motion to assume an executory contract or unexpired lease have generally based their decisions upon the notion that federal bankruptcy policy is offended where a non-debtor party seeks enforcement of a cross-default provision to extract priority payments under an unrelated agreement. The *Kopel* court stated:

> [W]here the non-debtor party would have been willing, absent the existence of the cross-defaulted agreement, to enter into a contract that the debtor wishes to assume, the cross-default provision should not be enforced. However, enforcement of a cross-default provision should not be refused where to do so would thwart the non-debtor party's bargain.

Once again, it is noteworthy that witness Nienhueser testified that the Landlord would not have made the bargain with the Debtor, absent the "cross-default" clause. [JA 105-106]. There is no contrary testimony.

The *Kopel* court also examined a number of cases in which cross-default provisions were either enforced or denied enforcement. In *Bistrian v. Easthampton Sand & Gravel Co., Inc. (In re Easthampton Sand & Gravel Co., Inc.),*[30] a case involving facts similar to those in *Kopel*, the debtor leased a facility and purchased a manufacturing business operating in it by giving the seller a note representing a substantial percentage of the purchase price. In that case, the bankruptcy judge enforced a cross-default provision in the lease that made a default on the note a default under the lease, stating:

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[29] *In re Kopel*, 232 B.R. 57, 64 (Bankr. E.D.N.Y. 1999)(citing *In re Village Rathskeller, Inc.*, 147 B.R. 665, 672 (Bankr. S.D.N.Y. 1992) which quoted from *In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1092 (3d Cir. 1990)).

> [E]quity will not countenance the debtor's exercise of [section] 365 to relieve itself of conditions which are clearly vested by the contracting parties as an essential part of their bargain and which do not contravene overriding federal policy . . . . [To do so] would deny the creditor the benefit of his bargain and would result in an unjust windfall for the debtor.[31]

The court in *Easthampton* focused on whether the transaction, taken as a whole, would have closed absent the insertion of the cross-default provisions in the interrelated contracts. The court enforced the cross-default provision based on a finding that the provision was part of the bargained for exchange.

In *In re T & H Diner, Inc.*,[32] the debtor executed a series of promissory notes representing the purchase price of a restaurant business operating in the premises leased from the former owner. The court found that the lease and series of notes formed one indivisible agreement constituting a single contract for purposes of state law so that the debtor's default under the notes precluded assumption of the lease.[33]

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[30] 25 B.R. 193 (Bankr. E.D.N.Y. 1982).

[31] *Id.* at 198-99.

[32] 108 B.R. 448 (D.N.J. 1989).

The bankruptcy judge in *Kopel* based his decision on the relationship between the agreements. The court analyzed the cross-default provision in the lease by examining its relationship to the promissory note. The court emphasized that there were numerous references to the lease in the other transaction documents.

> [T]he documentary evidence leads to the inescapable conclusion that the Note and Lease are essential elements of a single transaction . . . The cross default provision in the Lease must . . . be regarded as a necessary term, the absence of which would have halted the sale.

The *Kopel* court conceded that by enforcing the cross-default provision and requiring that all defaults under the note and consulting agreement be cured as a condition to the assumption of the lease, the debtors' reorganization would be hindered. However, the court could "discern no federal policy which requires severance of a lease condition solely because it makes a debtor's reorganization more feasible."[34]

Rather than following the well reasoned rationale of the *Kopel* decision, the bankruptcy judge below relied upon the dubious rationale of the bankruptcy court in *In re Sambo's*

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[33] The court in *Kopel* expressly avoided the issue of whether the lease, note, and consulting agreement before it constituted one contract under state law.

[34] *Id.* at 67-68 (citing *Easthampton Sand & Gravel*, 25 B.R. at 199).

Restaurants, Inc., 24 B.R. 755 (Bankr. C.D. Ca. 1982) and its progeny. [JA 228]. In *Sambo's*, the debtor and landlord had agreed to ten separate leases, each of which contained a "cross-default" clause. The procedural context for the *Sambo's* case is obscure, as the debtor had initially proposed to assume and sell one lease, but withdrew the proposed transaction. However, the landlord had filed an application for an order directing the debtor to assume or reject ten leases. The bankruptcy judge appears to have denied the landlord's request for an immediate ruling on such matter, and in connection with such interlocutory ruling concluded that the "cross-default" clauses among the ten leases were not enforceable. Citing Section 365(e)(1)(a), the bankruptcy judge in *Sambo's* concluded that contractual provisions conditioned upon the "financial condition" of the debtor are rendered inoperative by federal law. Remarkably, the *Sambo's* opinion states, "the limitations on the ability to assume and assign are found only in Section 365(c)." *Sambo's* at p. 757.

The *Sambo's* opinion is distinguishable from the instant case. The *Sambo's* court's conclusion that the "only" limitation on the ability to assume or assign is found in Section 365(c) flatly disregards the express requirements in Section 365(b) of the Bankruptcy Code. Section 365(b) sets forth the requirement that if there has been a default in an executory contract or unexpired lease, the trustee may not assume or assign such contract unless the trustee cures or provides adequate assurance that the trustee will promptly cure such default. Section 365(b) operates as a separate "condition" or "restriction" upon the debtor's ability to assume and assign an unexpired lease from those stated in Section 365(c). The *Sambo's* court ignored this plain requirement.

It is undisputed that certain "bankruptcy" and "insolvency" clauses are unenforceable under Section 365(b)(2). However, the "abandonment-default" clause, as found in the Energy Lease, is not tied to the financial condition of the debtor. Imagine the situation when the tenant under the Energy Lease is solvent financially viable, but makes a business decision that it no longer wishes to operate at one of the 27 premises. As discussed earlier, the debtor did not bargain for the right to have a rent reduction in such scenario, and Section 17.1(b) is not a "financial condition" clause that can be ignored in bankruptcy. The "financial condition" clause that may be ignored is a clause that prohibits assumption and assignment upon the "bankruptcy" of the tenant.[35] Bankruptcy courts have no statutory basis to override the lease clause at issue. Finally, *Sambo's* does not even address applicable state law.

Recently, in an unreported opinion, this Circuit Court recognized the significance of the inclusion of a cross-default clause, holding that the absence of a such clause established that the Debtor was not required to cure defaults as a condition to the assumption and assignment of a lease. *In re The Driggs Corp.*, No. 02-1028, 2003 U.S. App. LEXIS 55, at *621 (4th Cir. Jan. 3, 2003). The *Driggs* decision confirms the presence or absence of a cross-default-type clause is a material factor in determining whether contracts are integrated or divisible: "It is evident from the express language of the lease agreement that Driggs and Martin Marietta intended to have the lease contain obligations independent of those required under the terms of the invoices. Indeed, this conclusion is mandated by the absence of a cross-default provision in the lease." *Id.* In contrast to *Driggs*, the Landlord's appeal presents a single lease instrument, with a "cross-abandonment" provision to tie all the leased premises together.

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[35] Section 17.1(d) of the Energy Lease would be an example of a "financial condition" clause; it is not an issue in this appeal.

Even if this Circuit Court were to hold that the Energy Lease constitutes 27 separate leases, the *Kopel* and *Driggs* opinions are instructive on the proper enforcement of the cross-default clause in bankruptcy. Even if Circuit Court construes the Energy Lease as 27 separate leases, the abandonment-default clause (which functions under such construction as a cross-default clause) was an essential part of a simultaneous bargain pursuant to which the Debtor was granted possession of the 27 premises. There is no evidence in the record to the contrary. If this Circuit Court construes the Energy Lease as 27 separate leases, the presence of a cross-default clause, which was missing from the two separate documents in *Driggs*, compels a different outcome here.

In conclusion, the bankruptcy judge's assertion, that it is a "well-settled" federal law rule that a cross-default clause is unenforceable, is in error. This court should follow the well-reasoned cases of *In re Kopel*, *In re East Hampton Sand & Gravel Co.*, *In re T&H Diner, Inc.*, as well as *Driggs*, all of which support the enforcement of a "cross-default" clause. If the bankruptcy judge's ruling that the Energy Lease constitutes 27 separate leases is affirmed, the Debtor must still cure its defaults with respect to the 12 premises which have been abandoned, and for which no rents have been paid for many months. The bankruptcy judge permitted the rejection of the 12 premises, based upon an erroneous legal conclusion that the abandonment-default clause could be ignored in the future at the time of the lease assumption for the other 15 stores.

CONCLUSION

For the reasons set forth above, the March 18, 2003 Order of the district judge should in all things be reversed.

Respectfully submitted,

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REQUEST FOR ORAL ARGUMENT

Appellants respectfully request oral argument, as Appellants believe this will provide counsel with an opportunity to respond to the Court's questions about Texas contract law, and its interplay with the Bankruptcy Code.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

(omitted)

CERTIFICATE OF SERVICE

I, J. Maxwell Tucker, certify that on this 3rd day of July, 2003, two copies of the foregoing BRIEF OF APPELLANTS, including one copy of the separate Joint Appendix, was served by mailing a copy of same to each of the following persons at the following addresses:

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ADDENDUM TO BRIEF

1. Text of §365 of the Bankruptcy Code [11 U.S.C. § 365].

2. Copy of unpublished Fourth Circuit Opinion: *In re The Driggs Corp.*

APPENDIX F

RECORD NO. 03-1489 *[Filed 09/02/03]*

IN THE
UNITED STATES COURT OF APPEALS
For the Fourth Circuit

U.S. RESTAURANT PROPERTIES, INC., et al.,

Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., et al.,

Defendants-Appellees.

On Appeal From The U.S. District Court
For The Middle District Of North Carolina

APPELLEES CONVENIENCE USA, INC. ET. AL AND LASALLE BANK, NATIONAL ASSOCIATION'S JOINT MOTION TO DISMISS

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TABLE OF CONTENTS

(omitted)

TABLE OF AUTHORITIES

(omitted)

Appellees, Convenience USA, Inc., et al. (the "Debtors"), and LaSalle Bank, National Association ("LaSalle"), pursuant to Rule 27 of the Federal Rules of Appellate Procedure, hereby file this Joint Motion to Dismiss the Appeal of U.S. Restaurant Properties, Inc., U.S. Restaurant Properties Operating, L.P., USRP (Gant 1), LLC, USRP (Gant 2), LLC, USRP (Gant 3), LLC, USRP (Gant 4), LLC, USRP (Gant 5), LLC and USRP (Gant 6), LLC (collectively "USRP"), and respectfully request that the Court dismiss USRP's appeal based on the doctrine of equitable mootness, for the reasons more particularly set forth below.

DISCLOSURE PURSUANT TO LOCAL RULE 27(A)

Counsel for LaSalle has contacted counsel for USRP and informed counsel of the Debtors' and LaSalle's intent to file the instant Motion to Dismiss. Counsel for USRP represents that USRP opposes the granting of this Motion and intends to file a Response.

PROCEDURAL AND FACTUAL BACKGROUND

This appeal arises out of the bankruptcy case of the Debtors pending in the United States Bankruptcy Court for the Middle District of North Carolina (the "Bankruptcy

Court"). On July 29, 1999, Debtor Gant Acquisition LLC entered into a lease with USRP for 27 separate and distinct convenience store locations. On February 12, 2002, the Bankruptcy Court entered an order finding that the "Master Lease" between USRP as Landlords and Debtor Gant Acquisition LLC as Tenant was divisible into 27 separate and distinct leases, and permitting the Debtors to reject 6 of the leases covered by the Master Lease (the "First Rejection Order"). (JA 209-229.) USRP has appealed the First Rejection Order, but it did not seek a stay pending appeal of the First Rejection Order in either the Bankruptcy Court, the United States District Court for the Middle District of North Carolina (the "District Court"), or this Court. (Friederich Aff. ¶ 4.) In the absence of a stay, the Debtors closed the convenience stores at the 6 locations for which the Debtors rejected the USRP leases and surrendered possession to USRP. (Id.)

Thereafter, on October 21, 2002, the Bankruptcy Court, based on the facts and law set forth in the First Rejection Order, entered an Order that permitted the Debtors to reject another 6 leases covered by the Master Lease (the "Second Rejection Order"). (JA 230-34) USRP filed an appeal of the Second Rejection Order but again did not seek a stay pending appeal of the Second Rejection Order in either the Bankruptcy Court, the District Court, or this Court. (Friederich Aff. ¶ 4.) Following rejection, the Debtors surrendered possession of these 6 locations to USRP. (Id.) The Debtors also abandoned the underground storage tanks and any other equipment remaining at all 12 locations for which the Debtors rejected the USRP leases. (Id.)

The Debtors, in reliance upon findings, conclusions and orders of the Bankruptcy Court set forth in the First and Second Rejection Orders, negotiated with numerous creditors and parties to arrange a consensual resolution of the Debtors' business affairs, which resolution was embodied in the Amended Joint Plan of Reorganization filed on December 19, 2002 (the "Plan"). (Friederich Aff. ¶¶ 5 & 7.) USRP objected to the Plan. (Friederich Aff. ¶ 8.) At the confirmation hearing, USRP presented arguments but offered no evidence in support of its objections, and its objections to the Plan were overruled. (Friederich Aff. ¶ 9.) On February 12, 2003, the Bankruptcy Court entered an Order Confirming the Debtors' Joint Amended Plan of Reorganization (the "Confirmation Order"). (Friederich Aff. ¶ 9, Ex. C, ¶¶ 100-105 (hereinafter cited as "Confirmation Order ¶___."))

On February 14, 2003, USRP filed a Notice of Appeal initiating an appeal to the District Court (the "Confirmation Appeal") in which USRP appeals from the Confirmation Order "but only insofar as the Order pertains to the 15 stores leased from USRP that are part of the 143 stores covered by the Debtors' Plan and approves assumption and assignment of the 15 USRP stores leases pursuant to §§ 365 and 1123(b)(2) of the Bankruptcy Code." (Friederich Aff. ¶ 10, Ex. D.) No other party to these proceedings filed a notice of appeal as to the Confirmation Order. The Confirmation Appeal remains pending before the District Court. (Friederich Aff. ¶ 10.)

On February 14, 2003, USRP also filed a Motion for Stay Pending Appeal (the "Stay Motion"). (Friederich Aff. ¶ 11, Ex. E (hereinafter cited as "Stay Motion at ___.")) The Stay Motion, however, sought only a partial stay of the Confirmation Order "insofar as it pertains to the 15 stores leased from USRP." (Id. at 1) The Bankruptcy Court, after holding an evidentiary hearing, denied the Stay Motion by Order entered on February 21, 2003, and subsequent Memorandum Opinion filed on March 6, 2003. (Friederich Aff. ¶ 11, Ex. F (hereinafter cited as "Bankr. Op. at ___."))

USRP appealed the Bankruptcy Court's Order denying USRP's Stay Motion and requested that the District Court stay consummation of the Plan with regard to the 15 stores leased from USRP (the "USRP Stores") pending the resolution of its appeals. (Friederich Aff. ¶ 11.) On March 18, 2003, the District Court in a single Order affirmed the First and Second Rejection Orders, and denied USRP's Stay Motion. (JA 243-46.) USRP then filed a Notice of Appeal initiating the instant appeal of the First and Second Rejection Orders before this Court. (JA 247.) USRP, however, did not appeal the denial of the Stay Motion, and therefore the Debtors began to consummate the Plan.

A. SUMMARY OF PLAN STRUCTURE

The Plan provided for the transfer of substantially all of the assets of the Debtors to a group of new entities (collectively, the "EXPREZIT! Group"), with the assumption by such entities of numerous liabilities of the Debtors. (Friederich Aff. ¶ 5, Ex. A (hereinafter cited as "Plan § ___.") The remainder of the Debtors' assets, pursuant to the Plan, were transferred to a Liquidating Trust for the purpose of being liquidated with proceeds distributed to certain creditors. (Plan § 6.4.) Five secured creditors, including the largest, LaSalle Bank, voted to accept the Plan which resulted in the resolution of over $100 million of secured claims against the Debtors. (See Plan §§ 4.3-4.7; Confirmation Order ¶ 15.) The unsecured creditors, with non-priority claims aggregating approximately $20 million, voted to accept the Plan by at least a majority in number and two-thirds in dollar amount of those voting, and will receive pro rata distributions of approximately $1,050,000 under the Plan. (See id.) The Plan also provided for payment in full of certain priority tax claims of $1.3 million. (Plan § 4.2.) Further, the Plan provided for the assumption by the Debtors and the assignment to the

EXPREZIT! Group of numerous executory contracts, personal property leases, and real property leases. (Plan § 6.2(c).) Finally, the majority of the Debtors' 800 employees were offered jobs and are now employed by the EXPREZIT! Group. (O'Donnell Aff. ¶ 12.)

B. ACTIONS LEADING TO SUBSTANTIAL CONSUMMATION

Because no stay was obtained by USRP, the Debtors proceeded to close the EXPREZIT! Group transactions on March 21, 2003 ("Closing Date"), as well as to dispose of the remainder of their assets consistent with the Plan. (Friederich Aff. ¶ 13.) The disposition of the Debtors' property is described below:

1. Transfer of the "Core Stores" to EXPREZIT! Group

The main component of the Plan called for the Debtors to convey 143 "Core Stores" subject to a security interests of LaSalle, by deed or assignment of lease, as appropriate, to EXPREZIT! Group, along with substantially all of the personal property related to those Core Stores, plus $2 million in working capital. (Plan § 4.5(c)(1).) The Core Stores include the 15 USRP Stores. In exchange for the transfer of the Core Stores and related assets, EXPREZIT! Group assumed $48 million of the $88 million in secured debt owed to LaSalle, which is to be repaid by EXPREZIT! Group according to the terms that have been agreed upon by EXPREZIT! Group and LaSalle. (Plan § 4.5(c)(2).)

On the Closing Date, the Debtors, in fact, transferred to EXPREZIT! Group the Core Stores by executing 97 deeds and 46 assignments of leases, as well as assignments of 47 executory trade contracts and 197 equipment leases. (Friederich Aff. ¶¶ 13 & 19.) The Debtors also conveyed all inventory, goodwill, accounts receivable, deposits, trade fixtures, equipment and other intangible and tangible property plus furniture, fixtures and other office equipment used by the Debtors in the operation of the Core Stores, including but not limited to assets located at the Debtors' headquarters, as well as the inventory from the Debtors' other 21 stores (the "Non-Core Stores"). (Friederich Aff. ¶¶ 13 & 19; Plan § 6.2.) The Debtors also transferred all general intangibles, including guaranties and warranties, service contracts, supply agreements, franchise agreements, distribution agreements, trade names and trademarks to EXPREZIT! Group. (Id.) Finally, the Debtors transferred a total of $2 million from operating funds and the LaSalle Escrow Account to EXPREZIT! Group to be used as initial working capital. (Friederich Aff. ¶ 20.) The transfers to EXPREZIT! Group were free and clear of any liens, claims, mortgages, encumbrances or security interests, except for the claims, liens, mortgages, encumbrances and security interests of LaSalle. (Plan § 6.2; Friederich Aff. ¶ 21.)

At closing, EXPREZIT! Group assumed numerous obligations and liabilities of the Debtors. First, EXPREZIT! Group executed certain amended and restated loan agreements and certain amended and restated promissory notes to LaSalle in the aggregate of $48 million. (Friederich Aff. ¶ 17.) These notes were secured by first priority liens and security interests upon all of the transferred assets. (Id.) Second, EXPREZIT! Group assumed and has paid all liabilities incurred by the Debtors in the ordinary course of business from May 21, 2001 to the Closing Date, where such liabilities remained outstanding and unpaid as of the Closing Date, including but not limited to accrued but unpaid payroll and benefits, trade payables, sales tax liabilities, fuel tax liabilities, and equipment and other operating lease liabilities; EXPREZIT! Group has paid approximately $539,395.96 on such assumed liabilities since the Closing Date. (O'Donnell Aff. ¶ 7.) Third, EXPREZIT! Group assumed and paid the fee due Spectrum Capital, as investment bankers for the Debtors in the amount of $715,000. (Id.) Fourth, EXPREZIT! Group assumed all liabilities from the Debtors under 47 real property leases (46 stores plus headquarters) involving 29 landlords, numerous equipment leases with multiple Core Stores with 7 lessors, numerous operational contracts and merchandise contracts with multiple vendors. (O'Donnell Aff. ¶ 6.) Since the Closing Date, EXPREZIT! Group has been operating under such leases and contracts. (Id.)

EXPREZIT! Group has incurred new trade payables in reliance upon the Confirmation Order and the closing. As of May 31, 2003, EXPREZIT! Group had incurred new trade payables of $2,000,000. (O'Donnell Aff. ¶ 8.) In addition to acquiring trade payables, EXPREZIT! Group has entered into new contracts related to the operation of the Core Stores. (Id.) EXPREZIT! Group has entered into fuel supply contracts with several fuel suppliers, including supply contracts with BP-Amoco and Citgo. (O'Donnell Aff. ¶ 9(b).) These suppliers are supplying fuel for resale at EXPREZIT! Group's stores. EXPREZIT! Group was able to negotiate favorable terms with the fuel vendors based on the volume of fuel EXPREZIT! Group will purchase. (Id.) As a result, these contracts require EXPREZIT! Group to purchase a minimum amount of fuel. (Id.) EXPREZIT! Group also was required to post letters of credit in favor of BP-Amoco & Citgo totaling $1,350,000 as a guarantee of payment for fuel deliveries. (Id.)

For its non-fuel merchandise, EXPREZIT! Group has entered into a supply contract with HT Hackney Enterprises. (O'Donnell Aff. ¶ 9(b).) Pursuant to that contract, HT

Hackney is supplying EXPREZIT! Group with approximately 55% of its non-fuel merchandise, company wide. (Id.) EXPREZIT! Group has entered into a contract with Royal Cup whereby Royal Cup is supplying EXPREZIT! Group with coffee for resale at all of its locations company wide. (O'Donnell Aff ¶ 9(c).) Further, as a part of this agreement with Royal Cup, Royal Cup has developed an exclusive blend of coffee for EXPREZIT! Group, Joe Bean™ which EXPREZIT! Group has registered as a trademark. (Id.) In order to maintain the favorable pricing EXPREZIT! Group obtained with Royal Cup, EXPREZIT! Group must purchase a required minimum amount of coffee from Royal Cup. (Id.)

EXPREZIT! Group also has entered into various other contracts to enable EXPREZIT! Group to function as an ongoing business, including but not limited to contracts (1) to process fleet cards at its locations company wide (excluding stores located in remote areas with little transfer truck traffic); (2) to supply logistics coordination of fuel deliveries company wide; (3) to lease office space in Florida to serve as an operations center; (4) to establish new bank accounts; and (5) for insurance. (O'Donnell Aff. ¶¶ 9(d)-(i).) In order to conduct its business, EXPREZIT! Group also has obtained the issuance or transfer of licenses and permits from 62 separate federal, state and local government entities including Alcohol Beverage Control licenses and permits, fuel tax permits and business privilege licenses. (O'Donnell Aff. ¶ 10.) To obtain licenses for operations at its Florida Stores, EXPREZIT! Group was required to post letters of credit in favor of the Florida Department of Revenue totaling $185,000. (Id.)

Finally, EXPREZIT! Group has initiated capital improvement programs which are designed to improve the appearance and performance of numerous Core Stores. As of

July 23, 2003, EXPREZIT! Group has spent or signed contracts to spend $1,056,183 on capital improvements at 44 Core Stores, including $362,562 for the 15 USRP Stores. (O'Donnell Aff. ¶ 13.) In addition to EXPREZIT! Group's own capital contributions, vendors have agreed to spend their own money for capital improvements at Core Stores, including some USRP Stores, as part of the agreements reached with EXPREZIT! Group. (Id.)

2. **Transfer of the Non-Core Stores and Other Property to the Liquidating Trust**

On the Closing Date, the Debtors transferred to a liquidating trust (the "Liquidating Trust") all of the Debtors' causes of action and the 21 Non-Core Stores. (Friederich Aff. ¶ 13(d).) The Trustees of the Liquidating Trust are now in the process of liquidating those assets. (Id.) Since March 21, 2003, 7 of the 21 Non-Core Stores have been liquidated, generating net proceeds of $1,199,506.81. (Friederich Aff. ¶ 14(a)(v).) All inventory from the Non-Core Stores was transferred to the Core Stores, and thus to EXPREZIT! Group on or before the Closing Date. (Friederich Aff. ¶ 19.)

3. **Transfer of the Escrow Accounts to the Distribution Accounts**

During the bankruptcy case, the Debtors maintained 3 escrow accounts: (1) the EMAC Escrow Account, (2) the LaSalle Escrow Account, and (3) the Unsecured Escrow Account. The total balance of these 3 escrow accounts as of the Closing Date totaled approximately $7,818,938.62. (Friederich Aff. ¶ 14.) Since March 21, 2003, the funds in these accounts have been transferred to the Disbursing Agent for distribution pursuant to the terms of the Plan. (Id.)

With the transfers described above that occurred on the Closing Date, the transfer of substantially all of the

Debtors' property was complete. The additional transfers that have followed have resulted in nearly all of the Debtors' property being transferred out of the estates. Also, EXPREZIT! Group has received ownership of substantially all of the Debtors' property, the Disbursing Agent and the Liquidation Trustee have assumed their responsibilities over the balance of the Debtors' property, and distribution to creditors has commenced. (Id. at ¶¶ 14 & 19.) Since Confirmation, the Disbursing Agent has made distributions totalling $7,454,699.46 to EXPREZIT! Group, various professionals, and various secured and priority creditors. (Id. at ¶ 14(b).)

ARGUMENT

"[T]he doctrine of *equitable* mootness is a pragmatic principal, grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore unequitable." Mac Panel Co. v. Virginia Panel Co., (In re Mac Panel), 283 F.3d 622, 625 (4th Cir. 2002). In Mac Panel, this Court noted that "equitable mootness is often invoked when it becomes impractical and imprudent 'to upset [a] plan of reorganization.'" Id. (quoting In re UNR Indus., Inc., 20 F.3d 766, 769 (7th Cir. 1994)); see The Huntington National Bank v. Shawnee Hills, Inc. (In Re Shawnee Hills, Inc.), No. Civ. A. 2:02-0872, 2002 WL 31681538, at *2 (S.D.W.V. Nov. 19, 2002).

Equitable mootness is a pragmatic doctrine that asks not whether a court can fashion relief, but whether relief should be granted given substantial consummation of a plan of reorganization and alterations of the rights of third parties. Southern Pacific Trans. Co. v. Voluntary Purchasing Groups, Inc., 246 B.R. 532, 533 (E.D. Tex. 2000); Kuntz v. Saul, Ewing, Remick & Saul (In re Grand Union Co.), 200 B.R.

101, 104 (D. Del. 1996). "'Mootness' in the context of bankruptcy appeals is not an Article III inquiry as to whether a live controversy is presented, but is instead a recognition by the appellate courts that there is a point beyond which they cannot equitably order fundamental changes in reorganization actions." Southern Pacific Trans., 246 B.R. at 533.

Unlike constitutional mootness, equitable mootness is a flexible doctrine that "enables courts to dismiss appeals from orders confirming reorganization plans, even if effective relief could be fashioned, in order to avoid inequitable or unfair results." McLean Square Assocs. v. J. W. Fortune, Inc. (In re McLean Square Assocs., 200 B.R. 128, 132 (E.D. Va. 1996), aff'd, 107 F.3d 866 (4th Cir. 1997). "The doctrine rests on the need for finality, and the need for third parties to rely on that finality." TNB Financial, Inc. v. James F. Parker Interests (In re Grimland, Inc.), 243 F.3d 228, 231 (5th Cir. 2001).

In order to "determine whether judicial relief on appeal can, as a pragmatic matter, be granted," this Court has enumerated four factors that should be considered:

1. Whether the appellant sought and obtained a stay;
2. Whether the reorganization plan or equitable relief ordered has been substantially consummated;
3. The extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and
4. The extent to which the relief requested on appeal would affect the interest of third parties.

Mac Panel Co. v. Virginia Panel Corp. (In re Mac Panel Co.), 283 F.3d 622, 625 (4th Cir. 2002); Shawnee Hills, 2002 WL 31681538 at *2. These factors also have been applied by courts in various circuits throughout the country in making this determination. See, e.g., Continental Airlines, 91 F.3d at 560; Manges v. Seattle-First Nat'l Bank, (In re Manges), 29 F.3d 1034, 1038-39 (5th Cir. 1994), cert. denied, 513 U. S. 1152 (1995); In re U. N. R. Indus., 20 F.3d 766, 769 (7th Cir.), cert. denied, 513 U.S. 999 (1994); In re Chateaugay Corp., 988 F.2d 322, 325 (2nd Cir. 1993); Rochman v. Northeast Utils. Serv. Group, (In re Public Serv. Co. of N.H.), 963 F.2d 469, 471-72 (1st Cir. 1992). A review of the four Mac Panel factors in this case demonstrates that USRP's appeals has been rendered equitably moot by the substantial consummation of the Plan, and therefore should be dismissed.

A. USRP DID NOT OBTAIN A STAY.

USRP did not seek a stay of the First or Second Rejection Orders. Although USRP did attempt to obtain a stay of the Confirmation Order, first from the Bankruptcy Court and then from the District Court, it was denied a stay each time and sought no further appeal. As a result, the Plan was substantially consummated on the Closing Date, just as would have been the case had USRP not sought a stay at all.

"A stay not sought, and a stay sought and denied, lead equally to the implementation of the Plan of Reorganization." In Re U.N.R. Indus., Inc., 20 F.3d 766, 770 (7th Cir.), cert. denied; 513 U.S. 999, 115 S.Ct. 509, 130 L.Ed.2d 416 (1994); see also Mac Panel, 283 F.3d at 625 (holding that the first factor weighed in favor of dismissal although appellant sought a stay but requested relief was denied). The application of this factor does not depend upon whether a stay was merely sought, rather whether one was sought and obtained. Id.

Further, USRP sought only a "partial" stay of the Confirmation Order, requesting a stay only "insofar as [the Confirmation Order] pertains to the 15 stores leased from USRP." (Stay Motion at 1 & 3.) By its own admission USRP did not seek to stay consummation. The Bankruptcy Court recognized that USRP's request for a "partial" stay was not a stay motion at all, but rather a "novel" theory without legal support. (Bankr. Op. at 3.) As such, USRP failed to actually seek a stay below.

USRP's failure to obtain that stay has resulted in substantial consummation of the Plan. As the Third Circuit noted in Continental Airlines, "there is a procedure . . . to seek to preserve the status quo and '[t]he party who appeals without seeking to avail himself of that protection does so at his own risk.'" Continental Airlines, 91 F.3d at 562 (quoting Official Comm. of Unsecured Creditors of LTV Aerospace and Defense Co. v. Official Comm. of Unsecured Creditors of LTV Steel Co. (In re Chateaugay Corp.), 988 F.2d 322, 326 (2nd Cir. 1993)); Kassover v. Gibson, - - F.Supp. 2d - -, No. 02 Civ. 7978, 2003 WL 21222341, at *2-3 (S.D.N.Y. May 27, 2003). Thus, this first factor favors dismissal.

B. THE PLAN HAS BEEN SUBSTANTIALLY CONSUMMATED

The Bankruptcy Code defines "substantial consummation" as:

> (A) Transfer of all or substantially all of the property proposed by the plan to be transferred;
>
> (B) Assumption by the debtor or the successor to the debtor under the plan of the

business or of the management of all or substantially all of the property dealt with by the plan; and

(C) Commencement of distribution under the plan.

11 U.S.C. § 1101(2); MAC Panel, 283 F.3d at 626. Under the equitable mootness doctrine, courts refuse to undo what has been done pursuant to a substantially consummated plan. Although a court could fashion a remedy, under the circumstances where the plan has been consummated, and particularly where other parties have relied upon the confirmation of the plan, it would be inequitable to unravel the process that confirmation of the plan set in motion. Mac Panel, 283 F.3d at 625. "In such instances, the strong public interest in the finality of bankruptcy reorganizations is particularly compelling." Continental Airlines, 91 F.3d at 561. Thus, the Third Circuit in Continental Airlines indicated that substantial consummation has been the "foremost consideration" in assessing whether equitable mootness applies to bar a pending appeal. Continental Airlines, 91 F.3d at 560.

In this case, substantial consummation occurred on the Closing Date. On or before that date, the following actions occurred:

1. The Debtors transferred the Core Stores and related tangible and intangible assets, as well as the inventory from the Non-Core Stores, to EXPREZIT! Group (Friederich Aff. ¶ 19.);
2. EXPREZIT! Group amended and restated loan agreements and promissory notes to LaSalle, which notes totaled $48 million in replacement of

original loan agreements and notes in the approximate amount of $88 million (Id. at ¶ 17);

3. EXPREZIT! Group began operation of the Core Stores, entering into vendor contracts, selling inventory, paying employees, and generally engaging in all activities necessary to run a convenience store business at its 136 locations (O'Donnell Aff. ¶¶ 5, 8-13);
4. $2 million in working capital was transferred to EXPREZIT! Group (Friederich Aff. ¶ 20.);
5. All Non-Core Stores were transferred to the Liquidating Trust (Id. at 13(d));
6. The Debtors transferred $7,818,938.62 from the Escrow Accounts to the Disbursing Agent (Id. at ¶ 14(a)).

In addition to the substantial activity that occurred on the Closing Date, the following activities have occurred since that time to further consummate the Plan:

1. The Trustee of the Liquidating Trust has begun liquidating the Non-Core Stores, generating $1,199,506.81 in net proceeds for distribution to LaSalle (Friederich Aff. ¶¶ 13(d) & 14(a)(v));
2. Secured creditors have been paid a total of $1,660,000 (EMAC, $1,000,000; Morgan Stanley, $500,000; Ward, $50,000; Herndon Oil, $110,000) in exchange for releases of their claims (Id. at ¶ 14(b)(ix-xi));
3. LaSalle has been paid $1,800,000.00 as partial payment on its secured claim (Id. at ¶ 14(b)(xiv));

4. Creditors holding administrative expense claims have been paid $20,616.45; (Id. at ¶ 14(b)(ii));
5. Reclamation claims totaling $47,821.60 have been paid in accordance with Orders of the Bankruptcy Court (Id. at ¶ 14(b)(iii));
6. Lessors have been paid $80,922.75 as cure payments on leases assumed and assigned (Id. at ¶ 14(b)(iv));
7. Priority tax claimants, both secured and unsecured, have been paid $1,308,384.06 (Id. at ¶ 14(b)); and
8. NY Land Services has been paid $303,458.28 for closing fees and expenses in connection with real estate transfers at closing (Id. at ¶ 14(b)(viii)).

Therefore, substantial consummation was complete on March 21, 2003, and the activity since that date only further demonstrates that the Plan now has been substantially consummated. All of the Debtors' property has been transferred to either EXPREZIT! Group or the Liquidating Trust. EXPREZIT! Group has assumed control over the assets transferred under the Plan, and the Liquidating Trustee and the Disbursing Agent have assumed control over the remainder of the Debtors' property. Finally, distribution to creditors has begun, with 6 of the 8 creditor classes having been paid in full. (Id. at ¶ 14(b).)

The Third Circuit has stated that substantial consummation results in equitable mootness of an appeal "especially . . . where the reorganization involves intricate transactions." Continental Airlines, 91 F.3d at 560. The Bankruptcy Court found that "the USRP Stores are integral to a carefully crafted business plan upon which the transaction with EXPREZIT! Group and the Plan itself are based, and that the relief requested by USRP would throw the entire Plan into disarray." (Bankr. Op. at 3.) Certainly the transfer of 143 stores and the restructuring of nearly $100 million in secured debt constitutes an "intricate transaction" which should not be upset at this late date. Thus, this second factor also favors dismissal.

C. USRP'S REQUESTED RELIEF WOULD ADVERSELY IMPACT THE SUCCESS OF THE PLAN.

The third Mac Panel factor is what effect the requested relief will have upon the success of the Plan. Mac Panel, 283 F.3d at 625; see, e.g., Continental Airlines, 91 F.3d at 560; Southwestern Bell Tel. Co. v. Longshot Drilling, Inc., (In re Longshot Drilling, Inc.), 224 B.R. 473, 482 (10th Cir. B.A.P. 1998). This factor also favors dismissal.

If USRP were successful in its appeal to reverse the First and Second Rejection Orders, the success of the Plan would be placed in grave jeopardy. USRP likely will contend that its appeal only would affect the assumption and assignment of the Master Lease on 15 USRP Stores, and that therefore the entire Plan need not be upset. USRP's argument, however, is flawed in that it does not recognize that the 15 USRP Stores are critical to the entire success of the Plan.

At the hearing before the Bankruptcy Court on USRP's Stay Motion, the Debtors presented evidence and the Bankruptcy Court found "that eliminating the 15 USRP stores would be tantamount to eliminating all of the North Carolina stores because it is not feasible from either an operational or economical standpoint for EXPREZIT to operate only 15 stores in North Carolina when its remaining stores are located in Florida, Georgia and Alabama." (Bankr. Op. at 12-13.) In his testimony before the Bankruptcy Court on USRP's Motion to Stay and in his Declaration supporting this Motion, Jan Friederich, the chief executive officer of EXPREZIT! Group, testified that while 30 stores would support a regional supervisor and 3 district managers, 15 North Carolina stores could not support a regional supervisor or any district managers. (Friederich Aff. ¶ 16, Ex. H at 27-28 (hereinafter cited as "Hrg. Tr. at ___."); Friederich Aff. ¶ 24.) To effectively manage its stores, EXPREZIT! Group requires 1 district manager for every 10 stores, and 1 regional supervisor for every 30 stores. (Friederich Aff. ¶ 24.) Therefore, the 30 North Carolina stores will support 1 regional supervisor and 3 district managers. (Id.) Because the remaining 15 non-USRP stores are located across the State of North Carolina, there would not be enough density to support the regional supervisory management. (Hr. Tr. at 27; Friederich Aff. ¶ 24.) One district manager could not cover such a large geographic area, while there still would not be enough stores to support 2 district managers or 1 regional supervisor. (Friederich Aff. ¶ 24.) As a result, supervision and control of 15 non-USRP North Carolina stores could not be maintained efficiently and effectively. (Id.)

Financial concerns also would prevent EXPREZIT! Group from operating the 15 non-USRP North Carolina Stores without the USRP Stores. With only 15 stores in North Carolina, the overhead for North Carolina operations would be excessive. (Id. at ¶ 25.) The ability of the 15 remaining stores to obtain favorable terms and prices for vendors contemplated under EXPREZIT! Group's business plan also would be undermined. (Id.) Therefore, if EXPREZIT! Group could not have assumed the Master Lease for the 15 USRP Stores, the remaining 15 non-USRP North Carolina stores would have become impossible to operate, and EXPREZIT! Group would not have purchased the 15 non-USRP North Carolina stores. (Id. at ¶ 26.)

Without the 30 North Carolina stores, EXPREZIT! Group would not be able to attain a level of "critical mass" necessary to negotiate favorable terms with vendors or support overhead expenses on the remaining Core Stores in Georgia, Florida and Alabama. (Id. at ¶ 27.) For instance, EXPREZIT! Group negotiated a supply contract with Citgo. (Id. at ¶ 28.) That contract requires EXPREZIT! Group to purchase a minimum amount of fuel annually. (Id.) If EXPREZIT! Group fails to purchase the required minimum quantity, EXPREZIT! Group will be forced to purchase its fuel at higher prices from Citgo. (Id.) With the North Carolina stores, EXPREZIT! Group should be able to meet its minimum fuel purchase requirements. (Id.; O'Donnell Aff. ¶ 9(a).) It would be highly unlikely that EXPREZIT! Group could meet its minimum fuel requirements, however, if the high volume North Carolina stores were eliminated from EXPREZIT! Group. (Id.) The non-North Carolina EXPREZIT! Group stores under the Citgo contract do not generate enough gasoline sales to support a supply contract on the same favorable terms and conditions that EXPREZIT! Group was able to obtain with Citgo with the North Carolina stores included. (Id.) Similarly, without the North Carolina Stores, EXPREZTT! Group would have difficulty in meeting the minimum purchase requirements needed to maintain its favorable pricing terms from Royal Cup. (O'Donnell Aff. ¶ 9(c).)

Further, the lack of North Carolina stores would increase the share of overhead to the remaining 106 Core Stores to an unacceptable level. (Friederich Aff. ¶ 29.) EXPREZIT! Group projects it will maintain between $4 to $4.2 million in overhead expenses (expenses above direct store level expenses). (Id.) Most of these overhead expenses are fixed, and therefore that figure would not decrease significantly regardless of how many stores EXPREZIT! Group operated. (Id.) EXPREZIT! Group expects the 30 North Carolina stores to cover approximately $1 million of the total overhead. (Id.) Therefore, without the North Carolina stores, the remaining stores operations would have to cover an additional $1 million in overhead before profits could be generated. (Id.) That prospect would make EXPREZIT! Group's purchase of the other Core Stores too risky a proposition to justify EXPREZIT! Group's significant investment. (Id.) As such, EXPREZIT! Group would not have entered into a transaction to purchase any of the Debtors' stores if it could not also purchase and assume the leases on the 15 USRP Stores in North Carolina. (Id. at ¶ 30.)

USRP's argument that it may carve out its stores from the Plan and leave the remainder of the Plan intact ignores the reality of the chain reaction removing the 15 USRP Stores would have, not only on the other North Carolina operations, but the entire EXPREZIT! Group structure. Therefore, contrary to USRP's argument, any order requiring the 15 USRP Stores to be removed from the transfer to EXPREZIT! Group could result in a complete collapse of the Plan.

In considering USRP's Motion to Stay, the Bankruptcy Court observed that even a delay in EXPREZIT! Group assuming leases on the 15 USRP Stores likely would result in "the plan completely collapsing." (Bankr. Op. at 15.) The Bankruptcy Court also found that it was unlikely that a closing on the remaining stores would take place without the 15 USRP Stores. (Id. at ¶ 11.) Indeed, EXPREZIT! Group indicated it would not go through with the closing without the 15 USRP Stores. (Friederich Aff. ¶ 30.)

In reliance on the Confirmation Order, EXPREZIT! Group closed its transaction with the Debtors and has begun operating the Core Stores. Granting USRP the relief it now seeks would result in an unworkable business model for EXPREZIT! Group. EXPREZIT! Group then would be forced to seek relief from the Debtors, and the entire reorganization would collapse like a house of cards. Therefore, USRP's success on appeal would drastically impact in a negative way the chances of a successful reorganization.

D. SUBSTANTIAL CONSUMMATION HAS ALTERED THE RIGHTS OF THIRD PARTIES

The primary focus of the equitable mootness inquiry before this Court has been on the fourth Mac Panel factor; that is whether substantial consummation has altered the rights of third parties not before the Court. See, e.g., Central States, 841 F.2d at 96. This Court has held that "dismissal of the appeal on mootness grounds is required when implementation of the plan has created, extinguished or modified rights, particularly of persons not before the court, to such an extent that effective judicial relief is no longer practically available." Central States, Southeast and Southwest Areas Pension Fund v. Central Transport, Inc., 841 F.2d 92, 96 (4th Cir. 1988). In Central Transport, this Court noted that where reversal of a plan of reorganization "would require the undoing of financial transactions involving third parties," that an appeal of the order confirming the plan should be dismissed pursuant to the doctrine of equitable mootness. Id.

In this case, third parties' rights have been significantly altered by substantial consummation of the Plan. In order to grant the relief USRP seeks in its appeals, the rights of these third parties once again would have to be significantly altered.

The most obvious third party to rely on the consummation of the Plan is EXPREZIT! Group. In Continental Airlines, the Third Circuit stated that dismissal on equitable mootness grounds, is particularly appropriate "where outside investors have relied on the confirmation of the plan." Continental Airlines, 91 F.3d at 560-61. As an outside purchaser, EXPREZIT! Group occupies at least the same position as an investor, if it is not more favored by the courts. EXPREZIT! Group has justifiably relied upon confirmation of the Plan and has moved forward in managing its new assets. EXPREZIT! Group has entered into new vendor contracts, many of which contain minimum purchase requirements which must be met to maintain favorable pricing terms. (O'Donnell Aff. ¶ 9.) EXPREZIT! Group has spent time and money obtaining the licenses and permits it needs to operate a convenience store business across 4 states. (Id. at ¶ 10.) EXPREZIT! Group also has invested $1,056,183 towards capital improvements for the Core Stores, including $362,562 for the 15 USRP Stores. (Id. at ¶ 13.)

Other third parties who have relied upon confirmation of the Plan include: LaSalle, Morgan Stanley, EMAC, Herndon Oil, Ward, as well as the multitude of administrative and priority creditors who have already received payment on their claims. LaSalle, Morgan Stanley, EMAC, Herndon Oil and Ward, holders of secured debt in excess of $100 million have significantly altered their legal rights in reliance upon the Plan, as more fully set forth in the Plan.

This Court addressed a similar situation as the one currently before the Court in Mac Panel. In that case, a creditor of the debtor pursued an appeal of a confirmation order and judgment entering an injunction, but failed to obtain a stay of the confirmation order or judgment. Mac Panel, 283 F.3d at 624. Principals of the debtor, relying upon the confirmation order and injunction, made a loan to the debtor in the amount of $1.1 million to fund payments to creditors. Id. This Court recognized that it would be unfair to creditors who had received payment to undo the plan of reorganization and to seek the return of those funds. Id. at 626.

Likewise here, LaSalle, EMAC, Morgan Stanley, Ward, and Herndon Oil, as well as creditors holding administrative and priority claims collectively have received approximately $4.9 million as of July 29, 2003. (See Friederich Aff. ¶ 14(b).) To undo the Plan and seek the return of those monies at this late date not only would be cumbersome, but fundamentally unfair to these third parties who invested monies as well as others who received payments and have moved forward from the Closing Date under the assumption that these monies were theirs to spend as they chose.

In addition to these more obvious third parties, other parties who have relied upon the Confirmation Order and consummation of the Plan include vendors of EXPREZIT! Group. New trade terms have been negotiated with most of the old vendors of the Debtors in reliance upon confirmation of the Plan and EXPREZIT! Group assuming operations of the Core Stores. (O'Donnell Aff. ¶ 6.) Certain fuel suppliers have begun performing upgrades of fuel pump facilities at some of the Core Stores, including several of the USRP stores, and other merchandise vendors have committed to investing significant sums for capital improvements to all of the Core Stores. (Id. at ¶ 13.)

In Mac Panel, the debtor also had negotiated new deals with vendors based upon its emergence from bankruptcy. Mac Panel, 283 F.3d at 624. The Court held that the reliance of these investors and other third parties favored dismissal based on equitable mootness because "[a] significant amount of money was distributed and numerous promises were made based on the assumption that Mac Panel had successfully reorganized." Id. at 626. Similarly, EXPREZIT! Group's vendors have relied upon promises of EXPREZIT! Group based on the assumption that the Debtors' Plan had been confirmed and the transfers made pursuant to the Plan were final.

In Central States, this Court also addressed a similar issue and concluded that the appeal should be dismissed as moot. In that case, following an order confirming a plan of reorganization, the appellant appealed, but did not post the required supersedeas bond to effect a stay. Central States, 841 F.2d at 95. Therefore, implementation of the plan began soon after confirmation. Id. By the time the appeal was heard nearly three months later, significant transactions had been completed, including cancellation of the debtor's outstanding stock and issuance of new stock to a third party investor in exchange for a $1 million infusion. Id. In addition, a $12 million line of credit had been activated, and $5.7 million had been drawn down for use in discharging super-priority indebtedness. Id.

This Court held that while some of the steps taken in implementation of the plan could have been undone, the third party "had been allowed to put up its $1 million, and very substantial disbursements of money had been made to persons who were not parties to [the] proceeding." Id. The Court held that the appeal therefore was properly dismissed as moot. Id. at 96.

The Court recognized in Central States that because the relief sought by the appellant was "a complete reversal of the plan of reorganization," "'an unmanageable, uncontrollable situation for the Bankruptcy Court'" would be created by undoing the financial transactions that had occurred following confirmation. Id. (quoting In re Roberts Farms, Inc., 652 F.2d 793, 797 (9th Cir. 1981)). Similarly, here, the reliance of EXPREZIT! Group, creditors of the Debtors, as well as the various vendors with which EXPREZIT! Group has negotiated new supply terms makes unwinding of this Plan particularly unimaginable. This case presents a situation where "a comprehensive change in circumstances [has] occurred that cannot now be deconstructed." Kassover v. Gibson, - - F.Supp. 2d - -, No. 02 Civ. 7978, 2003 WL 21222341, at *3 (S.D.N.Y. May 27, 2003) (dismissing as equitably moot post-merger appeal of order approving settlement agreement and stock purchase agreement that created new entity). Because of the reliance of third parties on confirmation of the Plan and the transfer of property pursuant thereto, removing the USRP Stores would result in an unmanageable scenario for the Bankruptcy Court. As such, USRP's appeal has been rendered equitably moot and should be dismissed.

CONCLUSION

All of the four factors enumerated by this Court in Mac Panel weigh strongly in favor of dismissing USRP's appeal on the grounds of equitable mootness. Therefore, based on the foregoing, the Debtors and LaSalle respectfully request the Court to dismiss USRP's appeal.

Respectfully submitted, this the 2nd day of September 2003.

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APPENDIX G

RECORD NO. 03-1489

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

U.S. RESTAURANT PROPERTIES, INC., ET AL.,
Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., GANT ACQUISITION LLC;
LASALLE BANK CORPORATION,
Defendants-Appellees.

On Appeal From The United States District Court
For The Middle District Of North Carolina

AFFIDAVIT OF BARBARA O'DONNELL

Barbara O'Donnell, being first duly sworn, deposes and says as follows:

1. My name is Barbara O'Donnell. I am a citizen and resident of Chapel Hill, North Carolina. I am the Vice-President of Finance & Information Services Technology of EXPREZIT! Convenience Stores, LLC, which is part of a group of entities known collectively as the "EXPREZIT! Group" ("EXPREZIT Group").

2. I am familiar with the bankruptcy case filed by Convenience USA, Inc., Holiday Markets of Georgia LLC, C-Marts of the Carolinas LLC, Florida C-Marts LLC, Gant Acquisition LLC, Sun Mart LLC, Express Stores LLC, Georgia C-Marts LLC, North Carolina C-Marts, LLC, Nugget Oil, Inc., Nugget C-Marts, Inc. and C-USA I LLC (collectively the "Debtors").

3. On March 21, 2003, the Debtors transferred to the EXPREZIT! Group substantially all property of the Debtors' estates, including but not limited to the conveyance by deed or assignment of leases with respect to 143 convenience stores (the "Core Stores"), and the transfer of the cash on hand, on deposit and other cash-items having an aggregate value of $459,000.00, as well as $1,541,000.00 from the Disbursing Agent under the Debtors' Plan.

4. As part of my duties as Vice-President of Finance & Information Services Technology for EXPREZIT! Group, I have overseen the transition of the operation of the Core Stores from the Debtors to EXPREZIT! Group.

5. EXPREZIT! Group assumed operations of the Debtors' former business at the Core Stores as of March 21, 2003. EXPREZIT! Group later closed 7 of the Core Stores located in Florida, but continues to operate the 136 stores in North Carolina, Georgia, Florida and Alabama.

6. EXPREZIT! Group assumed all liabilities from the Debtors under 47 real property leases (46 stores plus headquarters) involving 29 landlords, numerous equipment leases with multiple Core Stores with 7 lessors, numerous operational contracts with multiple vendors, and numerous merchandise contracts with multiple vendors. Since the Closing Date, EXPREZIT! Group has been operating under such leases and contracts.

7. EXPREZIT! Group assumed and has paid all liabilities incurred by the Debtors in the ordinary course of business from May 21, 2001 to the Closing Date, which liabilities remained outstanding and unpaid as of the Closing Date, including but not limited to accrued but unpaid payroll and benefits, trade payables, sales tax liabilities, fuel tax liabilities, and equipment and other operating lease liabilities; EXPREZIT! Group has paid approximately $539,395.96 on such assumed liabilities since the Closing Date. EXPREZIT! Group has assumed and paid the fee due Spectrum Capital, as investment bankers for the Debtors in the amount of $715,000.

8. As of May 31, 2003, EXPREZIT! Group had incurred new trade payables of approximately $2,000,000. Since that time, EXPREZIT! Group has continued to accrue new trade payables.

9. Since March 21, 2003, EXPREZIT! Group also has entered into new contracts related to the operation of the Core Stores. A summary description of examples of some of those contracts is as follows:

a. Vendor Contracts - Fuel. EXPREZIT! Group has entered into fuel supply contracts with several fuel suppliers, including a 3 year supply contract with BP-Amoco, and an 8 year supply contract with Citgo. These suppliers are supplying fuel for resale at EXPREZIT! Group's stores. EXPREZIT! Group was able to negotiate favorable terms with the fuel vendors based on the volume of fuel EXPREZIT! Group will purchase. As a result, these contracts require EXPREZIT! Group to purchase a minimum amount of fuel annually. EXPREZIT! Group has posted letters of credit in favor of BP-Amoco & Citgo totaling $1,350,000 as a guarantee for payment for fuel deliveries. If EXPREZIT! Group fails to purchase the required minimum quantity, EXPREZIT! Group will be forced to purchase its fuel at higher prices from the fuel vendors. With the high volume North Carolina stores, EXPREZIT! Group should be able to meet its minimum fuel purchase requirements. It would be highly unlikely that EXPREZIT! Group could meet its minimum fuel requirements, however, if the high volume North Carolina stores were eliminated from EXPREZIT! Group. For instance, in April and May 2003, EXPREZIT! Group met its minimum purchase requirement with Citgo. Without the North Carolina stores, EXPREZIT! Group would not have met its minimum. Even if only the 15 USRP stores had been eliminated during this time period, EXPREZIT! Group would have missed its minimum purchase requirement by approximately 700,000 gallons each month. If EXPREZIT! Group failed to meet its minimum with Citgo, EXPREZIT! Group would be forced to purchase fuel from Citgo at too high a price to remain competitive with other fuel retailers.

b. Vendor Contracts - Merchandise. EXPREZIT! Group has entered into a supply contract with HT Hackney Enterprises whereby HT Hackney is supplying EXPREZIT! Group with approximately 55% of its non-fuel merchandise, company wide;

c. Vendor Contracts-Coffee. XPREZIT! Group has entered into a contract with Royal Cup whereby Royal Cup is supplying EXPREZIT! Group with coffee for resale at all of its locations company wide. Further, Royal Cup has developed an exclusive blend of coffee for EXPREZIT! Group, Joe Bean™, which EXPREZIT! Group has registered as a trademark. Royal Cup's pricing for EXPREZIT! Group is volume based. With 136 stores, EXPREZIT! Group should not have trouble meeting the minimum purchase amount required to remain at the current prancing structure. If the number of stores is reduced, however, EXPREZIT! Group will encounter difficulty in purchasing the required amount of coffee necessary to continue to obtain the favorable pricing it currently receives from Royal Cup.

d. Fleet Card Contract. EXPREZIT! Group has entered into a contract with Fuel Man to enable EXPREZIT! Group to process Fuel Man fleet cards at its locations company wide (as appropriate)[36], including 8 USRP Stores. As part of this new relationship with Fuel Man, EXPREZIT! Group is a significant vendor in the Florida Panhandle area accepting Fuel Man fleet cards.

e. Fuel Delivery Logistics. EXPREZIT! Group has entered into a contract with Tele-Point whereby Tele-Point is coordinating deliveries of fuel to EXPREZIT! Group's stores company wide, including the 15 USRP Stores.

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[36] 25 stores are located in remote areas with little transfer truck traffic. Therefore, fleet cards will not be available for use at these 25 stores.

f. Operations Center Lease. EXPREZIT! Group has entered into a five (5) year lease for office space in Florida to serve as an operations center.

g. Bank Accounts. EXPREZIT! Group has established 17 new bank accounts, each involving new contract agreements, new deposit slips, depository stamps, deposit bags and night deposit keys.

h. Insurance. EXPREZIT! Group has entered into new contracts for insurance, including property insurance, liability insurance, automobile insurance, and underground storage tank insurance. All of these contracts have been fully executed and the contracting parties have begun performance pursuant to contract terms.

If these contracts are cancelled EXPREZIT! Group would be in breach. Many of the contracts contain liquidated damages provisions requiring EXPREZIT! Group to pay fixed sums in damages upon cancellation.

10. Since March 21, 2003, EXPREZIT! Group has obtained the issuance or transfer of licenses and permits from federal, state, and local authorities in order to conduct its business. Examples of licenses and permits EXPREZIT! Group has obtained since March 21, 2003 are as follows:

a. Alcohol, Tobacco and Firearms License with the Federal Bureau of Alcohol Tobacco and Firearms for all stores;

b. Alcohol Beverage Control ("ABC") License with the state of Florida for 60 Florida stores;

c. Florida food permits from the Florida Department of Agriculture for 60 Florida Stores;

d. Florida Fuel Tax License from the Florida Department of Revenue for 60 Florida stores;

e. Georgia ABC permit from the Georgia Department of Revenue for all 36 Georgia stores;

f. Self-service Permits from the Georgia Insurance and Safety Department for all 36 Georgia stores;

g. 42 underground storage tank permits from the Georgia Department of Natural Resources for all 36 Georgia stores;

h. Alabama ABC permits from the Alabama Department of Revenue for all 4 Alabama stores;

i. North Carolina ABC permits from the North Carolina ABC Commission for 25 North Carolina stores;

j. North Carolina underground storage tank permits from the Department of Environment, Health and Natural Resources for 22 North Carolina stores; and

k. Various alcohol, business, privilege, and occupational licenses from 52 separate local government entities for all 136 stores.

In order to obtain these various licenses and permits, EXPREZIT! Group has spent significant amounts of time and money. Each license and permit required EXPREZIT! Group to complete an application process, some of which required background checks on EXPREZIT! Group personnel. To date, the licensing and/or transfer fees for EXPREZIT! Group company wide have totaled $98,810.55. In addition to licensing and transfer fees, in order to obtain the required licenses and permits for its Florida stores, EXPREZIT! Group has posted letters of credit with the Florida Department of Revenue totaling $185,000.

11. At EXPREZIT! Group locations in which lottery tickets are sold, EXPREZIT! Group was required to close and surrender all lottery tickets held by the Debtors. EXPREZIT! Group then completed a six page application for each individual location and was required to set up new bank accounts and electronic funds transfer information for its 95 locations where lottery tickets are sold.

12. Since March 21, 2003 EXPREZIT! Group has hired 853 employees, including 3 executive level employees, 3 regional supervisors, 13 district managers and 136 store managers The vast majority of these employees were previously employed by the Debtors.

13. Since March 21, 2003, EXPREZIT! Group has initiated capital improvement programs which are designed to improve the appearance and performance of numerous stores. As of July 23, 2003, EXPREZIT! Group has spent or executed contracts to spend $1,056,183 on capital improvements at 44 Core Stores, including $362,562 in for the 15 USRP Stores. In addition to EXPREZIT! Group's own capital expenditures, vendors have agreed to spend their own money for capital improvements at EXPREZIT! Group stores as part of agreements reached with EXPREZIT! Group. A summary description of examples of these arrangements is detailed below:

a. Citgo has spent, or has agreed to spend between $10,000 and $15,000 per location at

13 EXPREZIT! Group locations to improve EXPREZIT! Group pump facilities and signage. Nine of these locations are USRP stores;

b. BP-Amocco has spent or has agreed to spend between $10,000 and $15,000 per store at 2 EXPREZIT! Group locations to improve EXPREZIT! Group pump facilities and signage;

c. Frito-Lay has agreed to spend $40,000 company-wide for merchandising racks and other display materials based on 136 EXPREZIT! Group locations;

d. Sara Lee has agreed to spend $100,000 company-wide to upgrade EXPREZIT! Group's fast food capabilities based on 136 locations;

e. Pepsi has agreed to spend $100,000 to upgrade EXPREZIT! Group's fountain drink capabilities company-wide based on 136 locations; and

f. TDK Ventures, a car wash vendor, has spent approximately $10,000 per store at 4 of the USRP Stores to upgrade the car wash facilities at these locations.

FURTHER DECLARANT SAYETH NOT.

I declare under penalty of perjury that the foregoing is true and correct. Executed on the _31__ day of July, 2003.

/s/ Barbara O'Donnell

Barbara O'Donnell

Sworn to and subscribed before me
this the _31_ day of __July________, 2003.

/s/ Sonya J. Franks

Notary Public

My Commission Expires:

01/28/03

RECORD NO. 03-1489

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

U.S. RESTAURANT PROPERTIES, INC., U.S.
RESTAURANT PROPERTIES OPERATING, L.P.,
USRP (GANT 1), LLC, USRP (GANT 2), LLC,
USRP (GANT 3), LLC, USRP (GANT 4), LLC,
USRP (GANT 5), LLC, USRP (GANT 6), LLC,

Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., GANT ACQUISITION LLC;
LASALLE BANK CORPORATION,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

AFFIDAVIT OF JAN FRIEDERICH

Jan Friederich, being first duly sworn, deposes and says as follows:

1. My name is Jan Friederich. I am a resident of Destin, Florida

CHIEF RESTRUCTURING OFFICER OF THE DEBTORS

2. I am the Chief Restructuring Officer of Convenience USA, Inc., Holiday Markets of Georgia LLC, C-Marts of the Carolinas LLC, Florida C-Marts LLC, Gant Acquisition LLC, Sun Mart LLC, Express Stores LLC, Georgia C-Marts LLC, North Carolina C-Marts, LLC, Nugget Oil, Inc., Nugget C-Marts, Inc. and C-USA I LLC, the Debtors in the underlying Bankruptcy Case (collectively, the "Debtors").

3. On February 12, 2002, the United States Bankruptcy Court for the Middle District of North Carolina (the "Bankruptcy Court") entered an Order authorizing the Debtors to reject 6 unexpired leases for real property leased by EXPREZIT! Group from Appellant USRP. On October 21, 2002, the Debtors rejected 6 additional leases leased from USRP. Following each set of rejections, the Debtors surrendered possession of the stores covered by these leases to USRP. Since that time, the Debtors have not been in possession of any of the 12 surrendered stores. The Debtors have abandoned the underground fuel storage tanks and related equipment ("USTs") at the 12 locations covered by the rejected leases. The Debtors have no knowledge as to what use USRP has made of the 12 surrendered stores.

4. Although USRP appealed the Bankruptcy Court's Orders permitting the Debtors to reject the 12 Rejected Leases, USRP did not seek to stay the Bankruptcy Court's Orders permitting the implementation of the rejection. Thus,

the Debtors, in reliance upon the findings, conclusions and orders of the Bankruptcy Court set forth in the Memorandum Opinion, negotiated with numerous creditors and parties to arrange a consensual resolution of the Debtors' business affairs, which resolution was embodied in the Plan that included the assumption and assignment of the USRP 15 Assumed Leases.

5. On September 25, 2002, the Debtors filed their Joint Plan of Reorganization and Joint Disclosure Statement. Certain parties in interest, including USRP, filed objections to the Debtors' Joint Disclosure Statement. After negotiations with certain creditor groups and after an initial hearing on the objections to the Joint Disclosure Statement, the Debtors filed on December 19, 2002, their Amended Joint Plan of Reorganization (the "Plan"), dated December 19, 2002, incorporating certain negotiated agreements with creditor groups, and their Amended Joint Disclosure Statement dated December 19, 2002, providing some information requested in the objections to the disclosure statement. True and correct copies of the Amended Joint Plan of Reorganization and Amended Joint Disclosure Statement are attached hereto as Exhibits A and B, respectively.

6. After a further hearing on the Amended Joint Disclosure Statement, the Bankruptcy Court entered an Order Approving the Disclosure Statement and Fixing Time for Filing Acceptances or Rejections of the Plan Combined with Notice of Hearing.

7. The Plan provided for the transfer of substantially all of the assets of the Debtors to a group of new entities (collectively, the "EXPREZIT! Group"), with the assumption by such entities of numerous liabilities of the Debtors. The Plan provided for the assumption by the Debtors and assignment to the EXPREZIT! Group of numerous executory

contracts, personal property leases, and real property leases, including the 15 Assumed Leases. The remainder of the Debtors' non-core assets, pursuant to the Plan, were to be transferred to a Liquidating Trust for the purpose of being liquidated with proceeds distributed to certain creditors. Five secured creditors, including the largest, LaSalle Bank, voted to accept the Plan which resulted in the resolution of over $100 million of secured claims against the Debtors. The unsecured creditors, with non-priority claims aggregating approximately $20 million, voted to accept the Plan by at least a majority in number and two-thirds in dollar amount of those voting, and will receive pro rata distributions of approximately $1,050,000 under the Plan.

8. Certain parties, including USRP, filed objections to the Plan. On February 7 and 10, 2003, the Bankruptcy Court held a confirmation hearing on the Plan. USRP presented argument but no evidence at the Confirmation Order.

9. At the conclusion of the confirmation hearing, the Bankruptcy Court announced its intention to confirm the Plan, and the Bankruptcy Court entered the Confirmation Order on February 12, 2003. A true and correct copy of the Confirmation Order is attached hereto as Exhibit C.

10. Thereafter, on February 14, 2003, USRP filed a notice of appeal in which USRP appealed to the District Court the Confirmation Order (the "Confirmation Appeal") "but only insofar as the Order pertains to the 15 stores leased from USRP that are part of the 143 stores covered by the Debtors' Plan and approves assumption and assignment of the 15 USRP stores leases pursuant to §§ 365 and 1123 (b)(2) of the Bankruptcy Code." A true and correct copy of USRP's Notice of Appeal is attached hereto as Exhibit D. No other party to these proceedings filed a notice of appeal of the

Confirmation Order. The Confirmation Appeal is now pending before the District Court.

11. On February 14, 2003, USRP also filed a Motion for Stay Pending Appeal (the "Stay Motion"), which the Bankruptcy Court, after conducting an evidentiary hearing, denied by Order entered on February 21, 2003, and Memorandum Opinion dated March 6, 2003. True and correct copies of the Motion for Stay Pending Appeal and the Bankruptcy Court's Memorandum Opinion are attached hereto as Exhibits E and F, respectively.

12. Thereafter, USRP appealed to the District Court, requesting that it overrule the Bankruptcy Court's Order denying USRP's Stay Motion and that it stay confirmation of the Plan with regard to the 15 Assumed Leases pending the resolution of the appeals involving these leases.

13. By a single Order dated March 18, 2003, the District Court affirmed the Bankruptcy Court's First and Second Rejection Orders, and also affirmed the Bankruptcy Court's Order denying USRP's Stay Motion. USRP appealed the District Court's Order to the United States Court of Appeals for the Fourth Circuit as it related to the First and Second Rejection Orders. USRP, however, sought no further appeal of the denial of its Stay Motion.

14. Attached hereto as Exhibit G and incorporated herein by reference is a copy of the Debtors' Consummation Status Report filed with the Bankruptcy Court on July 9, 2003. All of the matters and things set forth in the Consummation Status Report are true to the best of my knowledge.

15. As set forth in the Consummation Status Report, on March 21, 2003, following the entry of the Confirmation Order and denial by the Bankruptcy Court and the District

Court of Appellant USRP's requests to stay the Confirmation Order, the Debtors substantially consummated the Plan as follows:

a. The Debtors transferred to the EXPREZIT! Group substantially all property of the Debtors' estates as proposed by the Plan to be so transferred, including but not limited to the conveyance by 97 deeds and 46 assignments of leases with respect to 143 convenience stores (the "Core Stores"), and the transfer of the cash on hand, on deposit and other cash-items having an aggregate value of $459,000.00 as well as $1,541,000.00 from Escrow Accounts as noted below.

b. The Debtors assumed and assigned to the EXPREZIT! Group all of the 46 real property leases, 47 executory trade contracts, and 197 equipment leases to be assumed and assigned in connection with the transfer of the Core Stores. Such leases and contracts involved multiple third parties.

c. The EXPREZIT! Group, as transferee of such property and assignee of such leases and contracts, assumed operations of the Debtors' former business at the Core Stores as of the Closing Date. The Debtors have ceased all business operations and have no other on-going operations of their own. The Debtors no longer have any employees.

d. The Debtors transferred certain assets (the Non-Core Stores and the Causes of Action, including Bankruptcy Causes of Action) to

Richard M. Hutson, II and John A. Northen, in their joint capacity as the Liquidating Trustees, and they are in the process of liquidating such remaining assets and pursuing certain Causes of Action.

16. Further, following confirmation, the Debtors transferred to the Disbursing Agent, John A. Northen, the amounts on deposit in the LaSalle Escrow Account, the EMAC Escrow Account, and the Unsecured Escrow Account totaling $7,818,938.62. The Disbursing Agent commenced distribution under the Plan at and in conjunction with the Closing, and has continued distributions thereafter.

a. Since March 18, 2003, the date the District Court denied the request by USRP to stay the Confirmation Order pending appeal, and through and including June 30, 2003, the Disbursing Agent received $9,489,991.42, summarized as follows:

i. LaSalle Escrow Account, $6,007,498.69.

ii. EMAC Escrow Account, $701,762.57.

iii. Unsecured Escrow Account, $1,109,677.36.

iv. Accrued interest on accounts through May 31, 2003, $2,716.52.

v. Sale of Non-Core Stores 722, 416, 427, 330, 522, 549, and 588, net proceeds of $1,199,506.81.

vi. Refund by EXPREZIT! Group of overpayment of initial working capital at Closing, after post-closing reconciliation of the transferred accounts, of $459,000.00.

vii. Recovery on Bankruptcy Causes of Action, for preferential transfers (Interstate, Dairy Fresh, and

Barber Dairies), in the aggregate amount of $9,838.47.

b. Since March 21, 2003, the Disbursing Agent has made distributions summarized as follows:

    i. EXPREZIT! Group, estimated initial working capital $2,000,000.00, subject to post-closing reconciliation of accounts and subsequent refund of any over-funding.

    ii. Administrative Expense claims totaling $20,616.45 (Fleet Business $15,000.00, and Viacom Outdoor $5,616.45).

    iii. Fuel Reclamation claims totaling $47,821.60 in accordance with Bankruptcy Court orders (BP Amoco $42,422.49, Chevron USA $2,951.66, Exxon Mobil $2,447.45).

    iv. Cure payments on leases assumed and assigned totaling $80,922.75 (USRP for property taxes $9,536.63, Ward $4,687.31, Geisens $2,731.65, Ranflo $1,304.25, Foster $4,232.95, Quality Oil $38,429.96, VF Leasing $20,000.00).

    v. Donald Draughon and Thomas Turner for health insurance premiums, pursuant to the Management Restructuring Agreement, $3,500.64 and $3,602.64 respectively.

    vi. Professional fees and expenses as approved by the Court totaling $229,106.34 (Hutson Hughes and Powell $48,603.50, Northen Blue $103,262.44, Pachulski Stang $30,149.53, Poyner & Spruill $28,411.37, and KPMG $18,679.50).

    vii. Priority tax claims, secured and unsecured totaling $1,308,384.06, of which $1,057,461.50

was paid by the Disbursing Agent and $250,922.56 was advanced to and paid by NY Land Services, Inc., for tax claims secured by real estate transferred at Closing.

viii. NY Land Services for closing fees and expenses in connection with real estate transfers at Closing, $303,458.28.

ix. Secured claim of Morgan Stanley, $500,000.00 (payment in full of Class 3 Claim).

x. Secured claim of EMAC, $1,000,000.00 (payment in full of Class 4 Claim).

xi. Secured claim of Herndon Oil, $110,000.00 (payment in full of Class 6 Claim).

xii. Secured claim of Ward (assigned to LaSalle Bank) $50,000.00 (payment in full of Class 7 Claim).

xiii. Miscellaneous trust expenses in connection with Non-Core Stores and other administrative expenses, $54,828.87.

xiv. Payments to LaSalle Bank on secured claim, $1,800,000.00 (partial payment on Class 5 Claim).

c. Administrative expenses and cure payments on leases and executory contracts which were not paid by the Debtors prior to confirmation and consummation of the Plan have been paid by the Disbursing Agent as approved by the Bankruptcy Court or invoices received by the Disbursing Agent in the aggregate amount of $392,577.69. In addition, the working capital due to the EXPREZIT! Group in the net amount of $1,541,000.00 ($2,000,000.00 less funds on hand, on deposit, or other cash items) and closing costs of $303,458.28 were paid at Closing.

d. The secured claims of LaSalle Bank have received the treatment set forth in the Plan, including but not limited to the receipt of amended and restated promissory notes and mortgages from the EXPREZIT! Group in the aggregate amount of $48,000,000.00 and cash distributions in the aggregate amount of $1,800,000.00 paid to LaSalle Bank. In addition, funds remaining in the Liquidating Trust are held for subsequent payment toward the LaSalle Bank secured claims, super priority administrative expense claim, and general unsecured claims. Distributions on this class will not be complete until the Plan is fully consummated and all distributions have been made.

e. Morgan Stanley, EMAC, Herndon Oil and Ward released their liens and security interests in exchange for the cash payments they received under the Plan.

B. CEO OF EXPREZIT! GROUP

17. I also am the owner and Chief Executive Officer of the group of entities known collectively as EXPREZIT! Group (the "EXPREZIT! Group").

18. On February 21, 2003, I testified at the hearing on the Motion for USRP for Stay Pending Appeal of Order and Confirmation of Plan. A copy of the portion of the transcript of that hearing setting forth my testimony is attached hereto as Exhibit H and incorporated herein by reference.

19. EXPREZIT! Group purchased the 143 Core Stores from the Debtors in the underlying bankruptcy case. This transaction closed on March 21, 2003 (the "Closing

Date"). EXPREZIT! Group amended and restated loan agreements and promissory notes to LaSalle, which notes totaled $48 million in replacement of original loan agreements and notes in the approximate amount of $88 million. These notes were secured by first priority liens and security interests upon all of the transferred assets.

20. Thirty of the Core Stores are located in North Carolina. Of the 30 North Carolina stores, 15 locations are leased from Appellant USRP through an Master Lease (the "USRP Stores").

21. On the Closing Date, the Debtors transferred to EXPREZIT! Group the 143 Core Stores by executing 97 deeds and 46 assignments of leases. The Debtors also conveyed all inventory, goodwill, accounts receivable, deposits, trade fixtures, equipment and other intangible and tangible property plus the furniture, fixtures and other office equipment used by the Debtors in the operation of the Core Stores, including but not limited to such assets located at the Debtors' headquarters, as well as the inventory from the Debtors' other 21 stores (the "Non-Core Stores"). The Debtors also transferred all general intangibles, including guarantees and warranties, service contracts, supply agreements, franchise agreements, distribution agreements, trade names and trademarks to EXPREZIT! Group.

22. Finally, the Debtors transferred a total of $2 million from operating funds and a LaSalle Escrow Account to EXPREZIT! Group to be used as initial working capital.

23. The transfers to EXPREZIT! Group were free and clear of any liens, claims, mortgages, encumbrances or security interests, except for the claims, liens, mortgages, encumbrances and security interests of LaSalle.

24. The Debtors assumed and assigned to EXPREZIT! Group all of the leases and executory contracts to be assumed and assigned in connection with the transfer of the Core Stores, including the leases for the 15 USRP Stores.

25. As I testified at the February 21, 2003 hearing before the Bankruptcy Court, eliminating the 15 USRP Stores from EXPREZIT! Group's transaction with the Debtors would have been tantamount to eliminating all of the North Carolina stores because it is not feasible from either an operational or economical standpoint for EXPREZIT! Group to operate only the 15 non-USRP stores in North Carolina when its remaining stores are located in Florida, Georgia and Alabama.

26. To effectively manage its stores, EXPREZIT! Group requires 1 district manager for every 10 stores and 1 regional supervisor for every 30 stores. Therefore, the 30 North Carolina stores will support 1 regional supervisor and 3 district managers. Because the remaining 15 non-USRP stores are located across the State of North Carolina, from the coast to as far west as Hickory, there would not be enough density to support the regional supervisory management. One district manager could not cover such a large geographic area, while there still would not be enough stores to support 2 district managers or 1 regional supervisor. As a result, supervision and control of 15 non-USRP North Carolina stores could not be maintained efficiently and effectively.

27. Further, with only 15 stores in North Carolina, the overhead for North Carolina operations would be excessive, the ability of the 15 remaining stores to obtain favorable terms and prices for vendors contemplated under EXPREZIT! Group's business plan would be undermined and the remaining stores could not be effectively managed since 15 stores would not justify the expense of the Regional

Supervisor, which is needed to manage the operation of multiple convenience stores.

28. Therefore, if EXPREZIT! Group could not have assumed the Master Lease for the 15 USRP Stores, the remaining 15 non-USRP North Carolina stores would have become impossible to operate, and EXPREZIT! Group would not have purchased the 15 non-USRP North Carolina stores.

29. Without the 30 North Carolina stores, EXPREZIT! Group would not be able to attain a level of "critical mass" necessary to negotiate favorable terms with vendors or support overhead expenses on the remaining Core Stores in Georgia, Florida and Alabama.

30. For instance, EXPREZIT! Group negotiated a supply contract with Citgo. That contract requires EXPREZIT! Group to purchase a minimum amount of fuel annually. If EXPREZIT! Group fails to purchase the required minimum quantity, EXPREZIT! Group will be forced to purchase its fuel at higher prices from Citgo, and would have difficulty competing with other fuel retailers in the relevant markets. With the North Carolina stores included, EXPREZIT! Group should be able to meet its minimum fuel purchase requirements. It would be highly unlikely that EXPREZIT! Group could meet its minimum fuel requirements, however, if the high volume North Carolina stores were eliminated from EXPREZIT! Group Stores under the Citgo contract. The non-North Carolina stores under the Citgo contract do not generate enough gasoline sales to support a supply contract on the same favorable terms and conditions that EXPREZIT! Group was able to obtain with Citgo with the North Carolina stores included.

31. Further, the lack of North Carolina stores would increase the share of overhead to the remaining 106 Core

Stores[37] to an unacceptable level. EXPREZIT! Group projects that it will have between $4 to $4.2 million in annual overhead expenses (expenses above direct store level expenses). Most of these overhead expenses are fixed, and therefore that the amount of annual overhead expenses would not decrease significantly regardless of how many stores EXPREZIT! Group operated. EXPREZIT! Group expects the 30 North Carolina stores to cover approximately $1 million of the total overhead. Therefore, without the North Carolina stores, the remaining stores' operations would have to cover an additional $1 million in overhead before profits could be generated. That prospect would make EXPREZIT! Group's purchase of the other Core Stores too risky a proposition to justify EXPREZIT! Group's significant investment.

32. For the reasons stated above, EXPREZIT! Group would not have entered into a transaction to purchase any of the Debtors' stores if it could not also purchase and assume the leases on the 15 USRP Stores in North Carolina.

FURTHER AFFIANT SAYETH NOT.
This is the 31 day of July, 2003.

/s/ Jan Friedrich
Jan Friederich

Sworn and subscribed before me this 31st day of July, 2003.

/s/ Sonya J. Franks
Notary Public

My Commission Expires:
01/28/2008

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[37] Shortly after the Closing Date, EXPREZIT! Group discontinued operations at 7 stores located in Florida.

APPENDIX H

RECORD NO. 03-1489 *[9/23/03]*

In the

United States Court Of Appeals

For The Fourth Circuit

U.S. RESTAURANT PROPERTIES, INC., ET AL.,

Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., ET AL.,

Defendants-Appellees.

On Appeal From The United States District Court For The Middle District Of North Carolina (Durham)

APPELLANTS' RESPONSE IN OPPOSITION TO THE MOTION TO DISMISS APPEALS AS MOOT

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TABLE OF CONTENTS

(omitted)

TABLE OF AUTHORITIES

(omitted)

APPELLANTS' RESPONSE IN OPPOSITION TO THE MOTION TO DISMISS APPEALS AS MOOT

U.S. RESTAURANT PROPERTIES, INC., et al. (the "Appellants" or "Landlord"), hereby file this Response in Opposition to the Appellees' Motion to Dismiss Appeal.

Response to Procedural and Factual Background

Appellees cite the Landlord's decision not to seek a stay pending of appeal of the Rejection Orders[1] as a factual basis for dismissal, and Appellees suggest that absent a stay pending appeal of the Rejection Orders, these Orders are unreviewable on appeal. However, obtaining a stay pending appeal is not a general prerequisite to appeals court review.[2]

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[1] Because of this Circuit Court's 20-page limit rule under Rule 27(d), this Response assumes familiarity with the Briefs on the merits filed by the Appellant.

[2] For example, the District Court in *In re KMart Corporation*, observed it was "highly unlikely" that a stay pending appeal would be successful in most situations, and declined to dismiss a bankruptcy appeal

Furthermore, if a stay pending appeal had been granted such that the status quo had been maintained, the Debtor-tenant would have had to pay an additional $48,196 per month of rents pending the outcome of the appeal to the Fourth Circuit. As a result of the unstayed orders below, the Debtor has unilaterally elected to reduce the rent in the amount of $48,196 per month ($578,358 annually).

Although Appellees have had the financial benefit of the orders below during the intervening months, Appellees propose to compound the "penalty" resulting from the absence of a stay pending appeal by evading Circuit Court review. However, their mootness argument ignores the fact there remains approximately 16 years left under the term of the Energy Lease. This Circuit Court can provide "effective relief" to the Landlord. Reversal of the Order below will permit the Landlord to assert the "full rent" of $130,930.80 per month against the Debtor and any assignee of the Debtor's interest in the Energy Lease for the next 16 years. Further, reversal of the Rejection Orders below will permit the Landlord to assert "back rents" against the Debtor estate and EXPREZIT! under § 3.4 of the Plan. Further, reversal will permit the Landlord to defeat the Debtor's claim pending in the courts below that the Debtor is the "prevailing party" in this lease dispute for purposes of attorney fees under par. 18.41 of the Energy Lease. [Joint Appendix at 51]. See also Argument IV herein.

The Appellees' mootness argument is based primarily upon the fact the Debtor's Chapter 11 plan was confirmed in

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as moot for failure to obtain a stay. *In re KMart Corporation*, 291 B.R. 818 (N.D. Ill. 2003).

the intervening months.[3] With respect to the Appellees' "plan mootness" arguments, the Landlord responds that the focus of the pending appeal of the Confirmation Order in the District Court is on Article 5.4 of the Plan, which provides with respect to the Energy Lease:

> 5.4 Grant Acquisition LLC Leases: On July 29, 1999, the Debtor Gant Acquisition LLC entered into a lease (the "Master Lease") . . . for 27 separate and distinct convenience store locations. On February 12, 2002, the Bankruptcy Court entered an Order and Memorandum Opinion finding that the Master Lease is divisible into 27 separate leases, each of which may be the subject of assumption or rejection under §365 of the Bankruptcy Code (the "USRP Leases"), and permitting the rejection of leases for six (6) convenience store locations . . . [p]ursuant to §§365(a) and 1123(b), the Debtors shall assume and assign to EXPREZIT! North Carolina, as of the Closing Date, the USRP Core Store Leases as identified above and listed on Exhibit 6.

Also relevant is the fact that the Plan at section 14.10 contains a "savings clause" which permits the severability of clauses which are held to be invalid by either the Bankruptcy

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[3] As a procedural point, evaluation of such "plan mootness" issues may be premature in the Fourth Circuit, as the Appellees have also filed a motion in the District Court below seeking to dismiss the pending appeal of the Confirmation Order. Attached to the Affidavit of J. Maxwell Tucker filed herewith ("Tab A") are copies of the District Court's docket sheet for case #03-CV-515, as well as true and correct copies of a similar motion to dismiss as moot and response that has been filed in the District Court. However, the Landlord does not oppose the Fourth Circuit resolving the plan mootness claim at this juncture.

Court or an appeals court, as defined in section 2.6 of the Plan.[4] While Appellees suggest that reversing the orders below requires the Court to "undo" all Plan transactions, that is simply not required. As noted in the Affidavit of Nancy Sedlak at par. 3 ("Tab B" hereto), subsequent to confirmation of the Plan, the Debtor's assignee EXPREZIT! has only paid monthly rentals of $82,734.25, which amounts to 63.18% of the rent claimed by the Landlord. The appeals court has the power to correct the bankruptcy judge's Confirmation Order, which the Landlord contends has authorized an assignment of a "modified lease" described above in Section 5.4 in the Plan, rather than assignment of the actual Energy Lease. The Circuit Court can provide "effective relief," for example, it can condition the Debtor's (and its assignees') right to possession of the leasehold for the next 16 years, upon its undertaking to pay the full base rent.

A. **The Circuit Court can provide effective relief in this appeal concerning obligations due under a lease.**

Appellees' mootness arguments are premised largely upon a false assumption, namely that if the orders below are reversed, the appeals court must void the Debtor's assignment to EXPREZIT! of 15 of the 27 stores leased from the Landlord under the Energy Lease. This is based upon a misapprehension that the only "effective relief" the appeals court can provide is to order the Debtor's assignee EXPREZIT! to give back its leasehold interest. However, this Circuit Court can provide the Landlord with "effective relief" without divesting EXPREZIT! of its interests in the Energy Lease. The appeals court could reverse but hold that assignee EXPREZIT! is allowed to retain the 15 stores of the 27 premises covered by the Energy Lease, on the condition that it pay the full rent. In the alternative, the appeals court could require that assignee EXPREZIT! retain 15, accept other 12 premises covered by the Energy Lease, and pay full rent. The Affidavit of Nancy Sedlak, at paragraph 7, confirms these 12 other premises have not been sold or leased to a third-party.

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[4] Based upon pleadings they filed in the District Court, Appellees will likely reply that a reversal of the Confirmation Order which modifies paragraph 5.4 cannot be granted without compliance with 11 U.S.C. Section 1127(b). However, this is incorrect because the Plan includes a "savings clause" which recognized that plan provisions could be modified by reason of orders of the Bankruptcy Court (or appeals courts). Creditor's have already voted to accept a plan with this built in savings clause. This savings clause provision eliminates the need for a new plan and another round of creditor solicitation on an issue that is not material to most of the other creditors at this juncture.

This appeal is remarkably similar to the facts presented in *In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1086 (3rd Cir. 1990), wherein the Third Circuit rejected a similar mootness argument. The bankruptcy court held unenforceable and excised a certain paragraph of the lease ("paragraph 20"), which provided that "in the event that Tenant's gross sales for the first six (6) lease-years of the term of this Lease do not average Seven Hundred Eleven Thousand Two Hundred Forty Five and 00/100 Dollars ($711,245.00) per lease-year either Landlord or Tenant may elect to terminate this Lease." The bankruptcy judge then approved the assignment of the lease (without paragraph 20) to an assignee European Collections.

The Landlord appealed, but failed to obtain a stay pending appeal. Nevertheless, the Third Circuit declined to dismiss the appeal on mootness grounds, and reversed on the merits. The Third Circuit noted the material distinction between a challenge to the validity of the assignment of the lease, and the determination of the assignee's obligations under the lease. A landlord's challenge to the former might be mooted absent a stay pending appeal, however the landlord's challenge to the latter is not moot. The Third Circuit observed at page 1085:

> "Denney has not challenged the assignment of the lease to European Collections. Accordingly, the issue before us is not the assignment of the lease, as the Trustee asserts, but rather whether the bankruptcy court had the authority to excise paragraph 20 of that lease. The request to dismiss as moot must be denied, because we find that under the facts of this case Denney was under no obligation to obtain a stay."

The Landlord does not require the appeals court declare the assignment of the Energy Lease void. However, a "live" controversy remains due to the disputed obligations of the Debtor's assignee under the Lease. As explained in the Brief on the merits, the Landlord claims the bankruptcy court below erroneously excised the "abandonment default" clause of the Energy Lease, which provides:

> 17.1 Default. The occurrence of any of the following shall constitute a material default and breach of this Lease by Tenant . . .
>
> The abandonment or vacation of any Leased Property by the Tenant or the sale by Tenant of all or a part of the business operated by Tenant at the Leased Property . . .

The bankruptcy judge's construction of the Energy Lease as divisible into 27 leases prevents the Landlord from declaring a default under Section 17.1 based upon the Debtor's "rejection" (abandonment) of 12 of the leased premises. Furthermore, under the Orders below, the Debtor and its assignee EXPREZIT! have been allowed to pay only 68.18% of the base rent. Like *Joshua Slocum*, this appeal seeks relief with respect to the Debtor's/assignee's obligations under the Energy Lease, not the fact an assignment occurred.[5] Consistent with the Third Circuit, in *In re Burger Boys, Inc.*, 94 F.3d 755 (2nd Cir. 1996), the Second Circuit has also held that appeal of an order allowing assumption of a lease is not barred by mootness. Under these persuasive Third Circuit and Second Circuit authorities, this Court has the power to correct the lower courts' erroneous construction of the Energy Lease, and can provide effective relief.

B. The Landlord's appeal is not moot under the Fourth Circuit case law.

In *MAC Panel v. Virginia Panel Corporation*, 283 F.3d 622 (4th Cir. 2002) the Fourth Circuit listed four **non-exclusive** factors to be considered. The factors are discussed below.

1. Whether the appellant sought and obtained a stay?

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[5] Based upon pleadings they filed in the District Court, Appellees will likely reply that the *Joshua Slocum* case can be distinguished because the trustee's assignment of the lease under Section 365 of the Bankruptcy Code occurred outside of a Chapter 11 plan. However, Section 1123(b)(2) of the Bankruptcy Code - which authorizes the assignment of a lease under a plan - expressly incorporates the requirements of Section 365 of the Code. Since Congress clearly intended that landlords would have the same rights under Section 365 whether the assignment occurs inside or outside of a plan, there is not compelling reason to have two mootness rules as implicit in Appellee's position, namely that (i) appellate review is allowed as to the proper construction of leases assigned outside of a plan, but (ii) appellate review is denied as moot with respect to the proper construction of leases assigned under a plan.

2. Whether the reorganization plan has been substantially consummated?

In *MAC Panel,* the Fourth Circuit noted the appellant only sought a stay from the bankruptcy court. In contrast, here the Landlord sought a stay of the Confirmation Order from both the bankruptcy court and the district court.[6] The request for a stay pending appeal was denied. However, Landlord made all reasonable efforts to seek a stay.[7] It should be again noted that in *In re Joshua Slocum Ltd., supra,* 1086 (3rd Cir. 1990), the Third Circuit observed the landlord was under "no obligation to obtain a stay" in a similar lease dispute. While it appears that the debtor's plan has been "substantially consummated" within the meaning of Section 1101(2) of the Bankruptcy Code, "[o]rders confirming plans of reorganization do not become immune from appellate review upon their partial, or even substantial consummation." *Central States v. Central Transportation, Inc.* 841 F.2d 92, 96 (4th Cir. 1988).

3. The extent to which the relief requested on appeal would affect the success of the reorganization plan.

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[6] A further appeal of the denial of the stay to the Fourth Court would have been unavailable, as the denial of a stay is interlocutory, and circuit courts only have jurisdiction over appeals from "final" orders of the bankruptcy courts. *See* 28 U.S.C. § 158(d), and *Matter of Hester*, 899 F.2d 361 (5th Cir. 1990).

[7] Appellees also argue that Landlord only sought a "partial stay." However, the Plan is divisible (see Savings clause at sec. 14.10). Its proponents recognized the possibility that only a particular "clause or provision" might be reversed. Landlord properly focused its stay request on the Plan provision that has damaged the Landlord.

4. The extent to which the relief requested on appeal would affect the interests of third parties.

Landlord will discuss these overlapping *MAC Panel* factors with reference to (i) the General Unsecured Creditors, (ii) the Secured Creditors, (iii) the Debtors, and (iv) the Debtor's assignee EXPREZIT!.

General Unsecured Creditors. Reversal will not upset the "success of the plan" from the perspective of the Debtor's general unsecured creditors. The plan is a "pot" plan, meaning a defined contribution of assets has been made to a liquidating trustee for the general unsecured creditors. Specifically, as set forth on pages 25-26 of the Debtor's Disclosure Statement, a contribution of approximately $1.1 million cash has been set aside for payment of general unsecured creditors after payment of professional expenses. On page 3 of the Report attached at Tab G to Appellee's Motion, there is a disclosure that the $1.1 million creditor fund has been established. This $1.1 million "pot" to be shared among the general unsecureds is not subject to adjustment based upon the results of this appeal. Thus, these general unsecured creditors will not be affected by the relief requested by the Landlord. Furthermore, the unsecured creditors committee participated in the hearings below, have been served with notice of this appeal and briefs, and thus are not "third parties" which might require protection under an equitable mootness rule.

Secured Creditors who have received payments under the Plan. The Appellees refer to several million dollars of cash and property distributions made to LaSalle, Morgan Stanley, EMAC, Herndon Oil, and Ward. See Appellees Motion at page 12. Appellees argue at page 18 it is "fundamentally unfair" to these persons to "seek the return" of these payments. However, this is a false issue, as the Landlord does not request that these recipients be ordered to disgorge payments that have been made under the Plan. Rather, the Landlord is requesting that it be allowed to enforce the entire Energy Lease agreement against the Debtor's assignee EXPREZIT!. This Circuit Court need not order LaSalle, Morgan Stanley, EMAC, Herndon Oil, and Ward to refund the monies they received before it can provide Landlord with effective relief on appeal.[8] Furthermore, LaSalle is clearly a party to this appeal, and is not a "third-party" which requires protection.

The Debtor. Substantially all of the Debtor's assets have been assigned to EXPREZIT! and the Plan's disbursing agent. Ultimately, the Debtor will be dissolved. Reversal of the Orders will not affect the "success of the plan" from the perspective of the Debtor in any material sense, as the Debtor has ceased business and no longer have any material assets. Furthermore, the Debtor is not a "third party" which deserves protection under the mootness rule.

There is a material distinction between "Success of Plan" and the "Success of EXPREZIT!" The Appellees argue that reversal of the Rejection Orders "would adversely impact the success of the Plan." However, in order for the Debtor's Plan to be "successful" all that was required is that the Debtor deliver the property, cash, promissory notes and related instruments to the classes of creditors or their representatives as provided in the Plan. So long as the Debtor delivered such items on the Effective Date of the Plan, the Debtor is not in "default" under the plan. It appears the Debtor has made the deliveries of its properties and cash as promised. And for purposes of a "plan success" analysis required by the equitable mootness test, so long as the Debtor has delivered the property, cash, promissory notes and others instruments as required by the Plan, the Plan should be considered a "success" for purposes of equitable mootness.

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[8] In *KMart*, *supra*, the District Court observed that the fact the challenged payments had been made did not moot the appeal.

However, to evade appellate review, the Appellees would extend the "Plan success" test far beyond any legitimate purpose. Appellees suggest that the mootness test requires examination of whether reversal will impact the success or failure of EXPREZIT! This extension of the "success" text to the Debtor's assignee is not required by the *Mac Panel* opinion.

The only duty imposed by the Plan upon the Debtor with respect to EXPREZIT!'s note obligations, is that the Debtor cause EXPREZIT! promissory notes to be delivered to LaSalle at closing. See generally the Plan at Section 4.5 (pages 15 – 21). While the Plan describes the terms of the notes to be issued by EXPREZIT!, all that is required of the Debtor is to cause substantially all of its assets to be assigned to EXPREZIT!, and to have EXPREZIT! deliver the new promissory notes at closing to LaSalle. The Debtor did not guarantee these new promissory notes.

The Debtor's Plan does not provide a remedy if EXPREZIT! were to default under these notes. Inspection of Section 12.1 of the Plan, which concerns the retained jurisdiction of the bankruptcy court after confirmation of the plan, reveals that no bankruptcy court jurisdiction is retained to enforce the promissory notes issued by EXPREZIT!. While 12.1(g) refers to jurisdiction to determine a "default under the Plan," there is no reference to a default by EXPREZIT!. Furthermore, while the Appellees describe in excruciating detail various contracts that EXPREZIT! made with its vendors, a failure by EXPREZIT! to honor its obligations to its vendors is not an event of default under the Debtor's Plan. Stated otherwise, there is no "cross-default" clause in the Plan that makes a default by EXPREZIT! an event of default under the Plan.

Thus, the "success of the Plan" is not dependent upon whether EXPREZIT! honors its obligations to third party vendors, or pays its notes to LaSalle. The Plan does not intertwine the business success or failure of EXPREZIT! with the success or failure of the Plan. Accordingly, while reversal of the Rejection Orders may well have a financial impact on EXPREZIT!, reversal does not impact the "success" of the Plan.

EXPREZIT! assumed the risk of appeal. The Appellees' mootness argument is largely constructed around business problems that assignee EXPREZIT! contends will follow from its projected loss[9] of the 15 premises in North Carolina covered by the Energy Lease. Friederich testifies "that it is not feasible from either an operational or economical standpoint for EXPREZIT! to operate only the 15 non-USRP stores in North Carolina." See Friederich Affidavit on page 11 at par. 25. Friederich testifies that EXPREZIT! requires the sum of the 15 USRP stores and the 15 non-USRP stores to reach a "critical mass" needed to negotiate favorable terms with vendors. Friederich Affidavit at page 12, par. 29. Friederich testifies that without these 30 North Carolina stores, EXPREZIT!'s "purchase" of the other stores would have been "too risky." Friederich Affidavit at page 13, par. 32.

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[9] Note, however, Landlord does not require EXPREZIT! to give back the 15 premises, provided that the full base rent is paid. As argued earlier herein, the projected loss of the leasehold interest is a false assumption.

In response, it should be noted that in the Debtor's Disclosure Statement (Tab B to Appellee's Motion, at page 27), signed by Mr. Friederich, the following material plan risk is disclosed:

> D. Gant Acquisition LLC Leases.
>
> The USRP Litigation between Debtor Gant Acquisition LLC and USRP is described in Article IV, Section D(g) above. The Plan provides that the Debtors will assume leases for 15 convenience store locations leased from USRP and assign those leases to EXPREZIT! North Carolina. The orders of the Bankruptcy Court allowing rejection of the other 12 stores originally leased from USRP are on appeal to the United States District court for the Middle District of North Carolina. As in all litigation, there is some risk that the appellate court will not affirm the orders of the Bankruptcy Court. If that occurred, then the Plan may need to be modified based on the final rulings of the appellate court and any subsequent proceedings in the Bankruptcy Court. [emphasis added]

Clearly, Friederich was aware there was a risk that the Landlord could prevail on appeal.[10] Friederich, the chief executive officer of the Debtors, is also the owner and manager of the Debtors' assignee EXPREZIT!, as noted in Paragraph 6.1 of the Plan, and in his Affidavit.

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[10] Based upon pleadings they filed in the District Court, Appellees will likely reply that this plan amendment risk as disclosed in the Disclosure Statement applies only to "pre-confirmation" amendments to the Plan. However, the quoted text found in the Disclosure Statement contains no temporal limitation on the risk that the provisions of the Plan might have to be modified by reason of a reversal on appeal.

Mr. Friederich knew (or should have known) that reversal might impact the terms and conditions under which EXPREZIT! could retain the 15 stores. Yet, Friederich chose to close the transaction, and allowed EXPREZIT! to enter into new transactions with vendors, knowing full well there was a risk that the Landlord might prevail on appeal. Remarkably, while the appeals were pending, Friederich designed his business projections without evaluation of how the business might operate without the 15 stores covered by the Energy Lease. See transcript of Friederich's testimony given on 2/21/2003, (Appellee's Motion, Tab H, at page 31).

Friederich could have negotiated terms contracts with his lenders (such as LaSalle) and his new vendors to minimize this business risk that the 15 stores might someday be taken back by the Landlord. Instead, Friederich chose to close the transaction and receive an assignment of the Energy Lease, with full knowledge of the pending appeal.[11] Federal appeals courts should not resort to use of "equitable" principles to protect Mr. Friederich and his EXPREZIT! entities from business problems that they could (and should) have anticipated.

EXPREZIT! is not a "bona fide purchaser." Friederich asserts that EXPREZIT! "purchased" the Debtor's leasehold interest. Friederich Affidavit at page 13, par. 32. Perhaps the word "purchase" was selected because the mootness doctrine has been applied to protect bona fide purchasers for value ("BFP"). *See e.g., Matter of Abingdon Realty* Corporation, 530 F.2d 588 (4th Cir. 1976)(appeal of sale to a "good faith purchase" for $6,770,000 held moot); *In re Abbotts Dairies of Pa., Inc.,* 788 F.2d 143 (3d Cir. 1986)(fair and valuable consideration given at bankruptcy sale when purchaser pays 75% of appraised value).[12] However, EXPREZIT! is not a "purchaser" of the leasehold interest. EXPREZIT! has not "paid" value (appraised or otherwise) for the lease. EXPREZIT! is a newly formed entity, whose function was to receive an assignment of the Debtor's assets and to assume certain liabilities associated with those assets. Article 5.4 of the Plan clearly provides that the lease was to be "assumed and assigned," not purchased. As a mere assignee, EXPREZIT! stands in the Debtor's shoes, and is subject to any relief the appeals court grants against the Debtor with respect to the Energy Lease.[13]

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[11] Based upon pleadings they filed in the District Court, Appellees will likely reply that reversal of the orders below should result in EXPREZIT! being allowed to "reconsider its decision in light of a material change to its deal" such that reversal could impact the "success" of the plan. But the voluminous closing documents that have been filed by Appellees in support of dismissal reveal that EXPREZIT! did not condition its obligation to close upon a successful resolution of this appeal. EXPREZIT! elected to close the transaction with full knowledge that the appeals were pending, and that the appeals presented a risk that the plan provisions concerning the USRP leases might be modified in the future.

Historically, the mootness doctrine has been limited to protect BFP's of the Debtor's assets. Extension of the mootness doctrine to protect a mere assignee is not required by current caselaw. Extension of the doctrine to mere assignees may encourage debtors to assign assets to newly formed entities in schemes to avoid appellate review, and is "bad policy."

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[12] This good faith purchaser rule is now codified at 11 U.S.C. §363(m).

[13] It is elementary ancient law that an assignee never stands in any better position than his assignor. He is subject to all the equities and burdens which attach to the property assigned because he receives no more and can do no more than his assignor." *Citibank v. Tele/Resources, Inc.*, 724 F.2d 266, 269 (2d Cir. 1983).

Furthermore, even if a BFP doctrine applied to EXPREZIT!, it only protects the purchaser's title, not the "economic value" of the assets acquired. While the Energy Lease may be rendered less valuable to the assignee if the Landlord prevails on appeal, the BFP doctrine does not protect an expectation as to the value or terms of the lease that is the subject of an appeal.

Response to the "financial success" arguments. The Appellees premise their claim of mootness based upon a factually complex (and disputed)[14] issue focused upon the possible impact of reversal on 15 of the 30 stores located in North Carolina. They argue that if the orders are reversed, this will result in the closure of 15 stores—without regard to the alternative remedy that EXPREZIT! pay $48,196 of additional monthly rent to retain all 27 stores. They posit a supposed "snowball" effect that closure of the 15 will result in closure of other stores in North Carolina, and the elimination of a "middle management" position. Based upon this construct, they argue that reversal will render the Plan "unsuccessful."

Even if the assignee's "financial success" were a proper inquiry for mootness, examination of the Debtor's Disclosure Statement confirms that reversal will not doom EXPREZIT! to failure. Exhibit 5 to the Debtors' Disclosure Statement projects EXPREZIT!'s EBITDA for the years shown on the chart below. The Landlord asserts that the current base rent is $130,930.80, and that it is receiving $48,196 per month ($578,358 per year) less than required under the Energy Lease. However as demonstrated by the chart found in paragraph 4 of Affidavit of Nancy Sedlak, even if the Orders below are reversed, such that EXPREZIT! must pay the entire base rent of $130,930.80, EXPREZIT's business is not rendered "unsuccessful" from a financial perspective, as it would still have positive EBITDA, and an ability to pay the notes to LaSalle.[15]

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[14] Due process requires, if these facts are material to a mootness claim, an opportunity for the Landlord to cross-examine the witness, conduct discovery, and perhaps offer expert testimony in rebuttal.

The Landlord asserts that appeals court jurisdiction should not be dependent on a "success" test which inquires whether the Debtor's assignee will achieve certain profit margins. However, to the extent an "economic analysis" is appropriate, reversal will not compel financial doom, as indicated by the EXPREZIT! financial projections.[16]

Other Material Factual Distinctions Between this Appeal and *MAC Panel*. In *MAC Panel*, the Fourth Circuit observed that the debtor's owners contributed new money into the enterprise of $1.1 million. They could have either used the $1.1 million to defend the lawsuit brought against them by VPC (the appealing creditor) or put the cash into the bankruptcy estate so that VPC and other creditors could be paid in full. In contrast, there is no evidence that Mr. Friederich has made a material "out-of-pocket" cash contribution to fund the Plan below. Section 6.2 of the Plan generally describes a series of assignment of cash and property by the Debtors to EXPREZIT! under the Plan. Section 6.2(b) discloses the assignment by the Debtor of $2 million of operating funds to EXPREZIT! While Appellees characterize EXPREZIT!'s expenditure of cash as an "investment" (see Motion to Dismiss at page 16, and also on page 18, a reference to "these third parties who invested monies"); the fact is that "new money" has not been "invested" by Jan Frederick or others in the EXPREZIT! enterprise. Rather the Debtors cash has been transferred to EXPREZIT! for use as working capital.

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[15] In assessing the proper scope of the *MAC Panel* "success" factor, it should be noted bankruptcy courts do not require a guarantee that a plan will be "successful" in order to confirm the plan. *See In re Briscoe Enter., Ltd., II,* 994 F.2d 1160 (5th Cir. 1993)(with respect to feasibility, the court need not require a guarantee of success). If a bankruptcy court is not required to find a guarantee of success to confirm a plan, why should the appeals courts limit their jurisdiction to aid in the assignee's financial success?

[16] Reliance on a "financial success" test to determine equitable mootness is very problematic. Appeals courts may not be able to resolve disputed business fact issues without a remand, resulting in yet further delays in bankruptcy appeals.

In *MAC Panel*, the Fourth Circuit placed substantial weight on the fact that VPC was the "sole competitor" of the debtor. In sharp contrast, the Landlord is not a competitor of the Debtor or EXPREZIT!.

In *MAC Panel*, VPC was to be paid in full under the plan. In contrast, under the bankruptcy courts' construction of the Energy Lease, the Landlord will not be "paid in full." Rather, it will at best receive only 68.18% of the base rent. In sum, the facts of this appeal are markedly different from those in *MAC Panel*. The "equities" do not support dismissal under a mootness rule.

C. **The "Equitable Mootness" Doctrine is not valid under Supreme Court caselaw, and should be abolished or curtailed.**

In Argument II, Landlord assumed the validity of the "equitable mootness" doctrine upon which the Appellee's Motion to dismiss is premised. The Landlord will next examine the origins of this doctrine, and will show that under the rationale of four U.S. Supreme Court cases, it should be abolished or curtailed.

In *In re Continental Airlines*, 91 F.3d 553 (3d Cir. 1996), a meritorious bankruptcy appeal was dismissed as "equitably moot" by the Third Circuit, sitting *en banc*, by a vote of seven-to-six. At page 567, Third Circuit Judge Alito wrote in dissent:

> The majority's decision in this case creates a bad precedent for our circuit. The majority adopts the curious doctrine of "equitable mootness," which it interprets as permitting federal district courts and courts of appeals to refuse to entertain the merits of live bankruptcy appeals over which they indisputably possess statutory jurisdiction and in which they can plainly provide relief. According to the majority, there is no clear rule for determining when a bankruptcy appeal is "equitably moot." Instead, this is said to be a discretionary determination to be made in the first instance by the district court based on a weighing of five factors that the majority has culled from the opinions of our "sister circuits." In my view, if the doctrine of "equitable mootness" has any validity, it is more limited than the majority holds.

Judge Alito was correct in questioning the validity and scope of this "curious" doctrine.[17] Indeed, this doctrine cannot be reconciled with at least four decisions of the U. S. Supreme Court (which were not discussed in *Continental Airlines*, nor by the Fourth Circuit in *MAC Panel)*.

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[17] Although it has adopted the mootness rule, the Third Circuit in *In re Zenith*, 329 F.3d 338, 347 (3rd Cir. 2003) recently noted that dismissal of a bankruptcy appeal under the equitable mootness rule should be the "rare situation" and not the norm.

The "Equitable Mootness" Doctrine is inconsistent with Supreme Court precedent regarding appeals of reorganization plans.

In *Mills v. Green*, 159 U.S. 651, 16 S.Ct. 132, 40 L.Ed. 293 (1895), the Supreme Court established the Article III mootness doctrine, holding that dismissal of a case without consideration of the merits is required when no "effectual relief whatever" can be fashioned. However, in two subsequent appeals involving "equity receiverships" and reorganizations, the Supreme Court declined to dismiss as moot appeals which challenged the reorganization plans.

Northern Pacific Railway Co. v. Boyd, 228 U.S. 482, 33 S.Ct. 554, 57 L.Ed. 931 (1913), involved claims against the reorganized Northern Pacific Railroad. Boyd, a judicial lien creditor of the bankrupt corporation, asserted his rights against the reorganized corporation ten years after the adoption of its plan. Under the equity receivership plan, the assets of the Northern Pacific "Railroad" were sold free and clear of all creditor claims to a new entity – the Northern Pacific "Railway." After the foreclosure sale, Boyd attempted to assert a lien against the Railway's assets – despite the foreclosure sale. Relief was granted by the Supreme Court. The Court ruled that it was unfair for the shareholders of the old Railroad to receive equity interests in the new Railway, when creditors such as Boyd had not been paid.

Significant for present purposes is the fact that investors claimed that Boyd should have been estopped from attacking a reorganization that had occurred ten years prior. They proceeded to argue that, in addition to encouraging reorganizations, the Court should require prompt action by those who oppose the reorganizations. This "estoppel" claim is similar to that advanced by the Appellees, that the Landlord should not be heard on appeal because it was unable to obtain a stay pending appeal.

Finding that the delay in pursuing litigation was "excusable if not absolutely unavoidable," the Supreme Court held that "Boyd's silence . . . did not mislead the stockholders, nor did his non-action induce them to become parties to the reorganization plan." *Northern Pacific*, 228 U.S. at 510. Turning to the instant appeal, the Landlord's inability to obtain a stay pending appeal below "did not mislead" the parties. It was fully disclosed in the Disclosure Statement that the Landlord would continue to challenge the Orders below. EXPREZIT! accepted the Energy Lease with full knowledge of the pending appeals. The *Northern Pacific* case counsels against dismissing the Landlord's appeal as moot.

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939), the Supreme Court addressed the conditions under which former stockholders might participate in a plan of reorganization. The former stockholders had participated under a so-called "new value" rule which allows shareholders of the bankrupt corporation to participate in the plan of reorganization prior to full satisfaction of creditors' claims. The investors cited their "new value" contribution to argue that the appeal should be dismissed as inequitable. In response, Justice Douglas, writing on behalf of the Court, refused to have its power of review derogated by a bargain struck between the reorganizers and the new value investors.

> The scope of the duties and powers of the Court would be delimited by the bargain which reorganizers had been able to make with security holders before they asked the intercession of the court in effectuating their plan. Minorities would

> have their fate decided not only by the court in application of the law of the land . . . but by the forces utilized by reorganizers in prescribing the conditions precedent on which the benefits of the statute could be obtained. (emphasis added)

Los Angeles Lumber, 308 U.S. at 129. Based on this language, bargains struck among the reorganizers (here the Debtor, EXPREZIT! and LaSalle) should be ignored by the appeals courts if they restrict judicial authority to adjudicate appeals. In substance, the Supreme Court has denounced the ability of parties to evade appellate court review through the device of "mootness engineering."[18]

Together, *Northern Pacific* and *Los Angeles Lumber* provide the Supreme Court's analysis of creditors' rights to attack the confirmation of a plan of reorganization on appeal. In both cases, the Supreme Court refused to estop parties from asserting their rights, and heard the merits of the claims – despite the fact that investor's had put "new value" in the deal and the plans consummated in the intervening years.

In light of *Northern Pacific* and *Los Angeles Lumber* (which were not discussed in *MAC Panel*), the "non-exclusive" factors to be considered in the application of equitable mootness, must include an "assumption of risk" factor. This would mean that as long as creditors have an "effective remedy" available, plan proponents such as EXPREZIT! who elect to close Plan transactions prior to exhaustion of appeals do so at their own risk.

The doctrine of "equitable mootness" appears to have been invented 42 years after *Los Angeles Lumber*. The seminal case is generally considered to be the Ninth Circuit opinion of *In re Roberts Farms, Inc.*, 652 F.2d 793 (9th Cir. 1981),[19] which involved a bona fide purchaser. It is curious that neither *Roberts Farms, Inc.* nor the mootness cases that have followed have cited *Northern Pacific Railway Co. v. Boyd* and *Case v. Los Angeles Lumber Products Co.* The message from these long-standing Supreme Court cases is that the closing of reorganization transactions do not moot appeals. While these cases were decided prior to the Bankruptcy Reform Act of 1978, the Supreme Court has held that these pre-1978 Bankruptcy Code precedents continue to be the law of the land, absent excess Bankruptcy Code text to the contrary. See *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 106 S.Ct. 755 (1986). The Bankruptcy Code provides no textual support for dismissal of this appeal as moot.

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[18] As noted earlier, EXPREZIT! relies upon factors under its control, such as dealings with its own middle management, vendors, and lenders as a basis to moot the appeal.

The "Equitable Mootness" Doctrine is inconsistent with the recent Supreme Court limitations on the development of equitable remedies by federal courts.

Over the last two decades, our federal circuit courts have invented a new "equitable remedy" in favor of appellees in bankruptcy appeals without the benefit of statutory authority. Under this new "equitable mootness" remedy, even in cases where a meritorious appeal is presented, the parties opposing a bankruptcy appeal may present facts showing their post-Plan confirmation conduct. Based upon "non-exclusive" factors, the appeals courts are to decide whether a bankruptcy appeal is moot. As Circuit Judge Alito notes in *Continental* at 568, the circuit courts have created this "equitable mootness" remedy even though (a) the bankruptcy appeal is not "moot" in any Article III sense of the term, (b) they unquestionably have statutory jurisdiction, and (c) they have a "virtually unflagging obligation" to exercise that statutory jurisdiction, citing *Colorado River Water Conservation District v. United States,* 424 U.S. 800, 817, 96 S.Ct. 1236, 1246, 47 L.Ed.2d 483 (1976).

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[19] Unfortunately, most circuits appear to have followed the Ninth Circuit's lead, and it appears the Supreme Court's holdings in *Northern Pacific* and *Los Angeles Lumber* were not briefed or considered in the post *Robert Farms* era. *See, e.g., Continental Airlines III*, 91 F.3d 553 (3d Cir. 1996); *In re Baker & Drake, Inc.*, 35 F.3d 1348 (9th Cir. 1994); *In re UNR Indus., Inc.*, 20 F.3d 766 (7th Cir. 1994); *In re Chateaugay Corp.*, 988 F.2d 322 (2d Cir. 1993); *In re Public Serv. Co.*, 963 F.2d 469 (1st Cir. 1992); *In re Crystal Oil Co.*, 854 F.2d 79 (5th Cir. 1988); *Central States v. Central Transp., Inc.*, 841 F.2d 92 (4th Cir. 1988); *Miami Ctr. Partnership v. Bank of New York*, 838 F.2d 1547 (11th Cir. 1988); *In re Bel Air Assocs.*, 706 F.2d 301 (10th Cir. 1983); *In re Information Dialogues, Inc.*, 662 F.2d 478 (8th Cir. 1981); *In re Hamady Bros. Food Mkts.*, 110 B.R. 815, 817-18 (E.D. Mich. 1990); *In re AOV Indus., Inc.*, 43 B.R. 468 (D.D.C. 1984), *rev'd on other grounds*, 792 F.2d 1140 (D.C. Cir. 1986).

Prior to 1999, perhaps the development of this remedy of "equitable mootness" could have been justified based upon inherent "equitable powers" vested in the federal courts under the Judiciary Act of 1789. However, a 1999 decision of the United States Supreme Court indicates that such reasoning is flawed. In *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319 (1999), the Supreme Court held that the federal courts are limited to such equitable remedies as existed in the English Court of Chancery in 1789, the year that Congress enacted the First Judiciary Act. We submit that corporate reorganization plans and "equitable mootness" were not remedies exercised by the 18th Century Court of Chancery. The broad reach of the *Grupo Mexicano* opinion is exemplified by the Court's inclusion of a quote of Joseph Story:

> If, indeed, a Court of Equity in England did possess the unbounded jurisdiction, which has been

> thus generally ascribed to it, of correcting, controlling, moderating, and even superceding the law, and of enforcing all the rights, as well as the charities, arising from natural law and justice, and of freeing itself from all regard to former rules and precedents, it would be the most gigantic in its sway, and the most formidable instrument of arbitrary power, that could well be devised. . . . [A] Court of Chancery might then well deserve the spirited rebuke of Seldon; "For law we have a measure, and know what to trust to—Equity is according to the conscience of him, that is Chancellor; and as that is larger, or narrower, so is Equity. T is all one, as if they should make the standard for the measure the Chancellor's foot. What an uncertain measure would this be? One Chancellor has a long foot; another a short foot; a third an indifferent foot. It is the same thing with the Chancellor's conscience."

The reference to the "Chancellor's foot" is very apropos to the problem created by the "equitable mootness" doctrine. Even if well intentioned, the "equitable mootness" doctrine requires district and circuit courts to evaluate complex plan transactions, in an effort to ascertain whether reversal will impact plan "success"--a very subjective concept. There is no statutory definition of "success." Under this equitable approach, we can expect the conscience of one judge to be troubled, but not another, as to the impact of reversal on a plan's "success." This is not a sound approach to commercial law. It is submitted that this late 20th Century remedy of "equitable mootness" as to bankruptcy appeals will not survive scrutiny under the 1789 equitable remedy cutoff principle announced in *Grupo Mexicano.*

The "Equitable Mootness" Doctrine is inconsistent with Supreme Court's expectation that the Article III federal courts will supervise and review the decisions of their Article I bankruptcy court adjuncts.

The instant appeal arises out an "Article I" bankruptcy judge's interpretation of Texas contract law. As the Supreme Court announced in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), there are constitutional problems presented when Article I bankruptcy judges exercise the judicial power of the United States without adequate review by the Article III judiciary.

The three branches of the Federal Government have ways to check each others' power, but, unlike the other two branches, the judiciary has its own built-in correction mechanism. If a judge has made a decision that is fundamentally wrong or does not correctly interpret the law, the higher courts can overturn that decision. Congress clearly expected that mistakes made by bankruptcy judges would be corrected by the Article III district courts and circuit courts. Congress granted district and circuit judges appeals jurisdiction under 28 U.S.C. §1408 over bankruptcy judges.[20] This statutory appeals jurisdiction grant does not include any "mootness" exception.

Thus, any judge-made "equitable mootness" limitation on appeals jurisdiction must take into account that by eliminating Article III judicial review, citizens may encounter unchecked error by bankruptcy judges in their orders confirming Chapter 11 plans. This problem is of constitutional magnitude, as our current bankruptcy jurisdictional system is premised upon the assumption that the Article III judiciary will review the orders of bankruptcy judges. In upholding a magistrate's (another "Article I" officer) power to rule on a pretrial motion, the Supreme Court has stressed the importance of review in maintaining sufficient Article III control over an adjunct. *United States v. Raddatz*, 447 U.S. 667, 681-82, 100 S.Ct. 2406, 2415-16, 65 L.Ed.2d 424 (1980). *Marathon* likewise emphasized the need for ample review of an "adjunct" by an Article III court. *Marathon,* 458 U.S. at 85, 102 S.Ct. at 2879 (Brennan, J., plurality opinion).

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[20] Where Congress intended to bar appellate review of bankruptcy court orders, it did so expressly. See 11 U.S.C. §363 (m), §364 (e). No provision of the Bankruptcy Code authorizes federal courts to refuse jurisdiction over an otherwise live appeal based on the "equities" presented.

Much like this appeal, the *Marathon* case arose in the context of an Article I bankruptcy judge deciding a state law issue. In the wake of *Marathon*, Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984 (BAFJA). Pub.L.No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of U.S.C. Titles 5, 11, and 28).

However, under the "equitable mootness" rule, the review by Article III judges of the Article I bankruptcy adjuncts has been sharply curtailed. Dismissal of this appeal under the mootness doctrine would deny complete judicial review by Article III courts of the bankruptcy judge's construction of a contract under Texas state law. If the current bankruptcy jurisdictional statute is to remain constitutional, the Article III courts should perform their supervisory duties over bankruptcy appeals. A broad bankruptcy mootness doctrine, which in effect makes the Article I bankruptcy judge a court of "first and last resort" is inconsistent with institutional concerns recognized in *Marathon* and could render the BAFJA unconstitutional.

In sum, *Northern Pacific Railway Co., Los Angeles Lumber*, *Grupo Mexicano*, and *Marathon* all counsel in favor of this Circuit Court exercising its statutory jurisdiction over this bankruptcy appeal. This Court should reach the merits.

D. **The instant appeal is not moot, even if the Court holds it is powerless to grant relief to the Landlord against EXPREZIT!**

It should be kept in mind that there are other disputes between the parties which remain "live." For example, as recently as May 13, 2003, the Debtors filed a pleading in the Bankruptcy Court entitled "Reply to USRP's Memorandum in Support of Objection to Debtors' Claim for Recovery of Attorneys' Fees" in which the Debtor seeks to shift its attorney's fees incurred in obtaining the orders below against the Landlord based upon section 18.14 of the Energy Lease which allows for an award of fees in favor of the "prevailing party." See attachment (vii) to the Affidavit of J. Maxwell Tucker, and Affidavit of Nancy Sedlak at par. 6. Reversal would negate this claim for fees.

E. **If the Court determines this appeal is moot under its formulation of the "equitable mootness" rule, then the Court should direct that the opinions below be vacated.**

When a case becomes moot while on appeal, the appeals court should vacate the judgment below and remand with a direction to dismiss. *See United States v. Munsingwear, Inc.*, 340 U.S. 36, 39 (1950). Vacatur (which is requested only as the last alternative) would free the Landlord from any precedential effect of the lower court orders and opinions authorizing the assignment of less than the entire Energy Lease.

WHEREFORE, Appellants respectfully request the Circuit Court deny the Appellees' Motion to Dismiss Appeal as Moot; and grant such other relief as the Court deems just and proper.

Respectfully submitted,

/s/ J. Maxwell Tucker
J. Maxwell Tucker, Esq.
WINSTEAD SECHREST &
MINICK P.C.

COUNSEL FOR APPELLANTS

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of September, 2003, a copy of the foregoing Response was served by mailing a copy of same to each of the following persons at the following addresses:

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APPENDIX I

RECORD NO. 03-1489

In the
United States Court Of Appeals
For The Fourth Circuit

U.S. RESTAURANT PROPERTIES, INC., ET AL.,
Plaintiffs-Appellants,

v.

CONVENIENCE USA, INC., GANT ACQUISITION LLC, ET AL.,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA (DURHAM)

AFFIDAVIT OF NANCY SEDLAK

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AFFIDAVIT OF NANCY SEDLAK

NANCY SEDLAK, being first duly sworn, deposes and says as follows:

1. "My name is Nancy Sedlak. I am a citizen and a resident of Collin County, Texas. I am more than twenty-one (21) years of age and am competent and authorized to make this Affidavit, and I have personal knowledge of the facts set forth herein.

2. I am an asset manager employed by U.S. Restaurant Properties, Inc., which, on behalf of certain affiliates, serves as the landlord (the "Landlord") with respect to 27 properties identified in the "Energy Lease" by and between the Landlord and Gant Acquisition LLC. I understand that the Energy Lease has been assigned pursuant to a bankruptcy plan to an EXPREZIT! entity.

3. Since the assignment, EXPREZIT! has paid the Landlord monthly rents in the amount of $82,734.25. However, under Landlord's interpretation of the Energy Lease, the current monthly base rent is $130,930.80. Accordingly, the Landlord is only receiving approximately 62.18% of the base rent claimed by the Landlord, resulting in a payment shortfall of $48,196.50 per month ($578,358 per year).

4. The Landlord has appealed the orders upon which the Debtor and EXPREZIT! rely in paying only $82,734.25 of rent per month. I understand that the Debtors take the position that reversing the orders below will impact the "success" of their Plan. However, I have reviewed the Debtor's Amended Joint Disclosure Statement and specifically Exhibit 5 thereto, which projects EXPREZIT! Group earnings before interest, taxes, depreciation and

amortization ("EBITDA") for the years of 2003 through 2007. Based upon this data taken from the Debtor's Disclosure Statement, I would direct the Court's attention to the chart below, which shows the EBITDA as projected by the Debtor, and then an adjusted "Net EBITDA" if EXPREZIT! were required to pay an extra $48,196.50 per month of rent. The Debtor's Disclosure Statement on page 19 states monthly payments of $241,568.12 will be due to LaSalle (this is annualized as $2,898,817). On the chart below, I show a projected net amount.

Year 2003	
Total EBITDA Less additional rents claimed by Landlord	$3,511,913 578,358
Net EBITDA if entire Energy Lease assumed	2,933,555
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	34,738
Year 2004	
Total EBITDA Less additional rents claimed by Landlord	$6,419,383 578,358
Net EBITDA if entire Energy Lease assumed	5,841,025
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	2,942,208
Year 2005	
Total EBITDA Less additional rents claimed by Landlord	$7,149,006 578,358
Net EBITDA if entire Energy Lease assumed	6,570,648
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	3,671,831

Year 2006	
Total EBITDA	$7,728,638
Less additional rents claimed by Landlord	578,358
Net EBITDA if entire Energy Lease assumed	7,150,280
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	4,251,463
Year 2007	
Total EBITDA	$8,357,413
Less additional rents claimed by Landlord	578,358
Net EBITDA if entire Energy Lease assumed	7,779,055
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	4,880,238

5. I further understand that the Debtor and EXPREZIT! contend that if the orders below are reversed, they may be required to surrender the entire Energy Lease, and cease some business operations in the State of North Carolina, but leaving them with operations in other states. In that regard, based upon the Debtor's data set forth in Exhibit 5 to the Debtor's Disclosure Statement, which are captured in the chart below, I show the total EBITDA for the EXPREZIT! Group, less the projected EBITDA allocable to EXPREZIT! North Carolina operations (see Disclosure Statement, Exhibit 5), and have calculated the resulting line item that I describe as the "Net EBITDA" if North Carolina operations EBITDA is removed. From this, I have also deducted the annual debt service required under the Plan to LaSalle, which information is found on page 19 of the Disclosure Statement. The results of these calculations is shown below.

Year 2003	
Total EBITDA	$3,511,913
Less North Carolina EBITDA	33,411
Net EBITDA if North Carolina closed	3,478,502
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	579,685
Year 2004	
Total EBITDA	$6,419,383
Less North Carolina EBITDA	919,332
Net EBITDA if North Carolina closed	5,500,051
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	2,601,234
Year 2005	
Total EBITDA	$7,149,006
Less North Carolina EBITDA	1,138,801
Net EBITDA if North Carolina closed	6,010,205
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	3,111,388
Year 2006	
Total EBITDA	$7,728,638
Less North Carolina EBITDA	1,289,426
Net EBITDA if North Carolina closed	6,439,212
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	3,540,395
Year 2007	
Total EBITDA	$8,357,413
Less North Carolina EBITDA	1,482,788
Net EBITDA if North Carolina closed	6,874,625
Annual Debt Service to LaSalle	2,898,817
Net of Debt Service to LaSalle	3,975,808

6. On May 19, 2003, I gave testimony before the bankruptcy court in yet another controversy between the Landlord and the Debtor regarding the amounts required to cure defaults under the Energy Lease, as required to allow the assignment of the Energy Lease to EXPREZIT!. At such hearing, the Debtor contended that it may offset rents due the Landlord, based upon a contention that the Debtor was the "prevailing party" in the disputes that are now the subject of the Landlord's pending appeals before the Fourth Circuit. This issue of whether the Debtor is the "prevailing party" remains in controversy between the parties.

7. The Landlord remains the owner of the 12 premises that are the subject of the rejection orders, and they have not been sold or leased to a third party.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on this 9th day of September, 2003.

/s/
NANCY SEDLAK

SWORN TO AND SUBSCRIBED before me on this 10th day of September, 2003.

/s/
Notary Public in and for the State of Texas

My Commission Expires: 10/03/06